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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1993

DONALD E. FARRAR, et al.,
Petitioners,

VS.

FRANCHISE TAX BOARD,
Respondent.

On Petition For Writ Of Certiorari to the California Court of Appeal, First District

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a State violates the Supremacy Clause when it imposes a tax-refund procedure which, by effectively prohibiting class-wide relief, deprives the Federal Government's investors of the means to redress the injury that an unlawful state tax has inflicted on the market for United States obligations?

PARTIES TO THE PROCEEDING

Petitioners are Donald Farrar, individually and on behalf of all others similarly situated, and Joan Farrar, his spouse. Below, petitioners moved to certify a class defined as follows:

> "All individual and corporate shareholders of the Capital Preservation Fund and the Capital Preservation Fund II and all beneficiaries of the Capital Preservation Treasury Note Trust who paid California income tax or incurred California income tax liability on distributions which they received from one or more of those three entities during one or more of the years 1982, 1983, 1984 and/or 1985."

Respondent is the Franchise Tax Board, an agency of the State of California.

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PETITION FOR WRIT OF CERTIORARI

Petitioners Donald Farrar, individually and on behalf of all others similarly situated, and Joan Farrar respectfully pray that a writ of certiorari issue to review the judgment and opinion of the Court of Appeal of the State of California, First District, entered in this case on April 22, 1993.

OPINIONS BELOW

The opinion of the California Court of Appeal is published at *Farrar v. Franchise Tax Bd.*, 15 Cal. App. 4th 10, 18 Cal. Rptr. 2d 611 (1993), and reprinted in the Appendix to this Petition at App. A-1. The order of the California Supreme Court denying petitioners' Petition For Review is reprinted in the Appendix at App. A-15. The trial court's rulings on petitioners' two successive motions to certify the class and resolve class issues were not published. The ruling on the second motion is reprinted in the

Appendix at App. A-12, and the ruling on the first motion is reprinted in the Appendix at App. A-14.

JURISDICTION

The decision of the California Court of Appeal affirming the denial of petitioners' second motion to certify class and resolve class issues was entered on April 22, 1993. On July 15, 1993, the California Supreme Court denied a petition for review. By Order of the Honorable Sandra Day O'Connor, dated October 5, 1993, the time to file this Petition was extended to November 12, 1993. App. at A-16. This Court's jurisdiction is invoked under 28 U.S.C. § 1257(a). *See* additional discussion of jurisdiction *infra* at p. 6, note 7.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The United States Constitution, article VI, clause 2 ("Supremacy Clause") provides, in pertinent part:

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the Supreme Law of the Land . . . any Thing in the Constitution or Laws of any States to the Contrary notwithstanding."

2. The United States Constitution, article I, section 8, clause 2, provides:

> "The Congress shall have Power . . . To borrow Money on the credit of the United States. . . ."

3. 31 U.S.C. Section 3124(a) provides, in pertinent part:

> "Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax. . . ."

4. California Revenue and Taxation Code Section 19055, as amended in 1986, provides, in its entirety:

> "Every claim for a refund shall be in writing, shall be signed by the taxpayer or the taxpayer's authorized representative, and shall state the specific grounds upon which it is founded. A claim filed for or on behalf of a class of taxpayers shall do all of the following:
>
> "(a) Be accompanied by written authorizations from each taxpayer sought to be included in the class.
>
> "(b) Be signed by each taxpayer or taxpayer's authorized representative.
>
> "(c) State the specific grounds on which the claim is founded."

STATEMENT OF THE CASE

A. Prologue: The Brown Litigation.

Respondent Franchise Tax Board ("the Board") taxed distributions from three mutual funds ("the Funds")[1] which invested exclusively in obligations of the United States. An aggrieved taxpayer, Sandra Brown, on behalf of herself and all similarly situated taxpayers, filed a claim with the Board for the refund of all taxes so-collected between 1978 and 1981. She later brought a class action in the California Superior Court. In 1983, relying upon this Court's decisions in *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), and *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), the Superior Court held that 31 U.S.C. Section 3124(a) prohibited the taxation of such distributions. In accord with the nationwide consensus on this

[1] The three mutual funds were plaintiffs below but were not parties to the appeal of the class certification ruling and do not join in this Petition. The Funds are the Capital Preservation Fund, the Capital Preservation Fund II, and the Capital Preservation Treasury Note Trust.

issue,[2] the California Court of Appeal affirmed. *Brown v. Franchise Tax Bd.*, 197 Cal. App. 3d 300, 242 Cal. Rptr. 810 (1987). In 1988, after the California Supreme Court denied review, the Board paid over $5 million in tax refunds to approximately 40,000 class members.[3] The average refund was $138.00.

Despite its complete success, the *Brown* case did not put an end to litigation over the Board's taxation of Fund dividends. During the five years between the Superior Court's ruling in *Brown* that the tax was illegal and the California Supreme Court's 1988 denial of review, the Board continued to collect the unlawful tax. Early in 1985, in the first of two affirmative steps to impede attempts by taxpayers to recover refunds of the tax for tax years later than those at issue in *Brown*, the Board distributed an internal bulletin directing its employees to respond to taxpayer questions pertaining to 1982 and subsequent tax years as follows:

> "Tell the Taxpayer 'the issue you raise is currently before the Superior Court in the class action suit *Brown et al., v. Franchise Tax Board.* Action on claims for refund raising this issue is being deferred until the case is decided and all appeals are exhausted. A considerable period of time could elapse before this occurs, and your patience in this matter is appreciated.' "

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[2] *E.g., Yurista v. Commissioner of Revenue*, 460 N.W.2d 24, 27-28 (Minn. 1990); *Comptroller of the Treasury v. First United Bank & Trust*, 320 Md. 352, 367, 578 A.2d 192, 199 (1990); *Borg v. Department of Revenue*, 308 Or. 34, 37-38, 774 P.2d 1099, 1101 (1989); *In re Thomas C. Sawyer Estate*, 149 Vt. 541, 543-44, 546 A.2d 784, 785 (1987); *Capital Preservation Fund v. Department of Revenue*, 145 Wis. 2d 841, 844, 429 N.W.2d 551, 553 (1988); *Andras v. Department of Revenue*, 154 Ill. App. 3d 37, 42, 506 N.E.2d 439, 443 (1987), *cert. denied*, 485 U.S. 960 (1988); *Matz v. Department of Treasury*, 155 Mich. App. 778, 784, 401 N.W.2d 62, 65 (1986). *See Lowenstein v. State*, 244 Neb. 82, 88, 504 N.W.2d 800, 804 (1993).

[3] The *Brown* class was potentially much larger than 40,000. However, only those class members who affirmatively opted *in* to the class received refunds, significantly reducing the magnitude of the State's liability.

This policy with respect to taxpayer inquiries remained in effect after the trial court in *Brown* entered its final judgment on June 27, 1986, ordering the Board to pay refunds to the plaintiff class. In April 1987, as the Board continued to counsel "patience" pending the completion of appeals in *Brown*, the statute of limitations on refund claims for 1982—the first tax year after those at issue in *Brown*—was about to expire.

The second of the affirmative steps the Board took to discourage refund claims for the post-1981 tax years came in 1986, when the Board persuaded the California Legislature to amend the notice-of-claim provision contained in Section 19055 of the Revenue and Taxation Code. The Board conceded, and the court below found, that the amendment to Section 19055 was adopted "in response to the *Brown* case." As the Board explained,

> "In the course of resolving the class action against the Board in *Brown*, the Board was required to expend an extraordinary amount of administrative effort and expense . . . in order to identify the class, notify and correspond with class members, evaluate their claims, and ultimately issue refunds. The Board's cost for the procedures required exceeded $1 million. [¶] In light of this, sometime after the class [in *Brown*] was certified, the Board drafted legislation to amend the claim filing requirements set forth in Revenue and Taxation Code Section 19055 . . . . [¶] The language which the Board drafted was eventually enacted into law in the amendments to Section 19055, effective September 22, 1986." (App. at A-17 - A-18)[4]

As construed by the court below, amended Section 19055 does not permit *any* taxpayer—not even an unnamed class member—to receive a refund without submitting a timely written

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[4] *See also* App. at A-2. In the trial court, petitioners objected that no competent evidence supported the Board's conclusory contention that the administrative cost of the class remedy in *Brown* "exceeded $1 million."

notice of claim.[5] Under the amended provision, a taxpayer must either submit that notice of claim directly to the Board, or else provide a "written authorization" that meets all of the requirements of a notice of claim to another taxpayer, who must then file that "written authorization" together with his or her own notice of claim.

B. The Case At Bar.

On April 10, 1987, less than seven months after the effective date of amended Section 19055, petitioners Donald and Joan Farrar filed an administrative claim for refunds on behalf of themselves and of all others who had paid California taxes on distributions received from any of the Funds in tax years 1982, 1983, 1984 and 1985. Petitioners did not attach authorizations of any class members but themselves to their notice of claim. When the Board failed to take any action on petitioners' refund claim even after the California Supreme Court had denied the Board's petition for review in *Brown*,[6] petitioners initiated this action in California Superior Court.

After the trial court denied petitioners' first motion for class certification without prejudice (App. at A-14), petitioners brought a second motion to certify the class. The trial court denied that second motion solely for failure to comply with amended Section 19055. App. at A-12.

On appeal,[7] the California Court of Appeal affirmed on the ground that amended Section 19055 "establish[ed] conditions to

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[5] The notice is required to be "in writing, . . . signed by the taxpayer or the taxpayer's authorized representative, and [to] state the specific grounds upon which it is founded." Cal. Rev. & Tax. Code § 19055.

[6] The Board's petition for review in *Brown* was denied on March 24, 1988. The Board did not seek review in this Court.

[7] California law recognizes an immediate right to appeal from an order denying a motion to certify a class; such appeal may not be deferred until entry of final judgment. *Stephen v. Enterprise Rent-A-Car*, 235 Cal. App. 3d 806, 811, 1 Cal. Rptr. 2d 130 (1991); *Guenter v. Lomas & Nettleton Co.*, 140 Cal. App. 3d 460, 465-66, 189 Cal. Rptr.

the availability of [a class] remedy" (App. at A-6) which petitioners had not met. It rejected petitioners' contention that, as applied to the vindication of the federal interests and rights at issue in this case, amended Section 19055 was preempted. The provisions of that Section, according to the court, served California's " 'exceedingly strong interest in financial stability' " (quoting *McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 37 (1990)), and thus were "consistent with constitutional demands." App. at A-10. In reaching this conclusion, the court did not acknowledge the possibility that federal law can preempt state rules of procedure. Because *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510 (1993), had not yet been decided in this Court, moreover, the decision below was not informed by a consideration of that case.

The California Supreme Court denied a petition for review on July 15, 1993. App. at A-15. Justice Mosk would have granted the petition. *Id.*

REASONS FOR GRANTING THE WRIT

This case raises issues of substantial importance to the United States Treasury. In violation of an implied constitutional and express statutory immunity, the Board collected a tax on obligations the Federal Government issues in order to fund the national debt. As this Court's cases have recognized, that tax depressed the market for those obligations; at the same time, it unjustly enriched the State. The question for the Court's decision is whether the Board must redress this injury to the Federal Govern-

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470 (1983). Accordingly, there will be no opportunity for further review in the California courts of the federal question presented here, nor will there be an opportunity to seek review of the federal issue in this Court upon entry of final judgment. *See Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 480-82 (1975) (jurisdiction properly in this Court where "the federal claim has been finally decided, with further proceedings on the merits in the state courts to come, but in which later review of the federal issue cannot be had, whatever the ultimate outcome of the case"); *New York v. Cathedral Academy*, 434 U.S. 125, 128 n.4 (1977) (jurisdiction exists where "possible developments on remand" could not "remove or otherwise affect" the federal issue).

ment's capital market, or whether it may instead retain the overwhelming majority of the unlawful tax proceeds on the basis of a procedural rule that California erected for the express purpose of protecting its own treasury.

Last Term, in *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510 (1993), this Court reaffirmed that the remedy for unconstitutional state taxation is governed fundamentally by *federal law*. *Id.* at 2519. A full refund is the *only* remedy that is sufficient under federal law where a State has imposed a tax like California's that federal law placed "beyond [its] power to impose." *McKesson*, 496 U.S. at 39. While this federal remedy vindicates the individual rights of injured taxpayers, its primary purpose in a case like this one is to redress the federal fisc which the unlawful state tax has invaded.

Granting refunds to the petitioners individually while denying relief to the class they seek to represent denies relief to the Federal Government's capital market, and thus offends the Supremacy Clause. The court below justified its denial of class-wide relief—the only relief that can redress the market injury inflicted by the State's tax—solely on the basis of the *cost* to the State of administering such relief. In effect, it elevated the fiscal interest of the State over that of the Federal Government.

Harper now makes it clear that the fiscal interests of the States, even when far more weighty than the interests the Board asserts here, are not sufficient to override the federal remedy for unconstitutional state taxation. Had *Harper* been decided a few months earlier, the court below would have had to conclude that the Board's interest in reducing the administrative cost of the market-wide relief to which the Federal Government is entitled did not justify a failure to afford that relief.

A. The Decision Below Improperly Disregards An Important Federal Interest.

1. The remedy petitioners seek grows out of the paramount federal interest behind 31 U.S.C. Section 3124(a),[8] an interest as critically important in the present era of untamed federal budget deficits as it was in the early days of the cash-strapped Republic.[9] First codified in 1862, the immunity afforded by Section 3124(a) serves to prohibit all state taxes which "adverse[ly] [a]ffect . . . the United States' borrowing ability" (*Rockford Life Ins. Co. v. Illinois Dep't of Revenue*, 482 U.S. 182, 190 (1987)), by "diminish[ing] in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 396 (1983) (quoting *Smith v. Davis*, 323 U.S. 111, 117 (1944)). *Accord, People v. Commissioners of Taxes & Assessments*, 67 U.S. (2 Black) 620, 17 L. Ed. 451, 455 (1862) (recognizing that the investor's liability to a tax imposed by the State "affect[s] the[ ] value [of the federal obligations] in the market, and [therefore affects] the free and unrestrained exercise" by Congress of its constitutional power to "borrow money on the credit of the United States").

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[8] That immunity statute is "principally a restatement of the constitutional rule" of implied intergovernmental tax immunity. *First Nat'l Bank v. Bartow County Bd. of Tax Assessors*, 470 U.S. 583, 593 (1985) (quoting *Memphis Bank & Trust*, 459 U.S. at 397). *See Weston v. City Council*, 27 U.S. (2 Pet.) 449, 467, 7 L. Ed. 481, 487 (1829).

[9] *E.g.* T. Merrill, *Public Contracts, Private Contracts, and the Transformation of the Constitutional Order*, 37 CASE W. RES. L. REV. 597, 601 (1987) ("the Continental Congress . . . had accumulated an enormous public debt during the Revolutionary War"). From the beginning, moreover, Congress carefully protected the market for federal securities from even those actions that were in the short-term interest of United States itself. For instance, as early as 1790, Congress soundly rejected a motion to discriminate against speculators who had purchased federal obligations at a discount in the secondary market, fearing that such discrimination "would impair the government's credit." E. J. FERGUSON, THE POWER OF THE PURSE at 297-301 (1961).

Federal law is uncompromising in requiring the full refund of any tax that infringes this crucial federal immunity. The same strict remedial requirements do not extend to every unconstitutional state tax; thus, if the tax is invalid solely because it is "*discriminatory*, though otherwise within the State's power to impose" (*McKesson*, 496 U.S. at 34), the State "retains flexibility" in choosing the means by which to remedy its violation of federal law: either it may "award full refunds to those burdened by [the] unlawful tax" or it may "issue some other order that 'create[s] in hindsight a nondiscriminatory scheme.' " *Harper*, 113 S. Ct. at 2519-20 (quoting *McKesson*, 496 U.S. at 40). But if, as in this case, the tax was altogether "beyond the State's power to impose" because the property or instrumentality taxed was itself cloaked with federal immunity, the State has "no choice" of remedy; there being no way to "cure [its] invalidity," the State must " 'undo' the unlawful deprivation by refunding the tax." *McKesson*, 496 U.S. at 39. *Accord, United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991) (refund is the "only logical relief" for tax collected in violation of intergovernmental immunity). *See also Department of Employment v. United States*, 385 U.S. 355, 357 (1966) (affirming refund of taxes unconstitutionally collected from instrumentality of the United States).

2. In pursuing this refund remedy on behalf of all investors similarly situated, petitioners advance the interest of the Federal Government in maintaining an attractive market in United States obligations. California's tax unquestionably depressed that market by penalizing individuals who elected to invest in those obligations. The confidence of the market can only be made whole by means of a market-wide—that is, a *class*-wide—remedy. In other words, the federal interest will not be vindicated unless California's fiscal concerns are required to yield so that essentially *all* of the unlawfully-taxed investors can be made whole in this action.

The United States relies on the private market to make itself whole by obtaining the refunds that alone will fully redress the fiscal injury to the United States. Thus, Section 3124(a)'s immunity has historically been enforced through suits brought by private individuals, and this Court recently reaffirmed the long-

settled rule that these individuals have standing to bring such suits. *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 814-15 (1989). But this is not to say that the satisfaction of any *particular* investor is tantamount to the vindication of the federal market interest. Although the State, by affording a refund of the unlawful tax to one or two individual investors, thereby satisfies its due process obligations to them, it does not vindicate the market interests of the United States unless it refunds substantially *all* of the tax proceeds. *See Memphis Bank & Trust Co.*, 459 U.S. at 396 (Section 3124(a) requires States to remedy "the *slightest* [diminution in] the market value or the investment attractiveness" of United States obligations) (emphasis added). Accordingly, California is not at liberty to erect rules of procedure that deprive investors of the means of procuring such market-wide relief.

California's notice-of-claim rule is detrimental to the maintenance of an attractive market for federal obligations for yet another reason. Protracted litigation is costly. Where, as here, the amount at stake for any one individual is far too low to justify the costs of enforcement,[10] the federal interest simply will not be vindicated unless the cost of enforcement can be shared.[11] Indeed, if enforcement costs cannot be shared, then tax laws like the one struck down in *Brown* will continue to be enforced indefinitely. Procedural devices which interfere with the ability of investors to pool their resources and effect economies of scale thus have the *direct* consequence of obstructing relief to the United States in cases like this one.

The interests of the United States are further disserved whenever an offending State, by erecting a procedural hurdle in the way of full, market-wide relief, succeeds in retaining the unjust proceeds of its tax. If permitted but once to contravene the

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[10] The average refund for the four-year period covered by the *Brown* litigation was less than $140. By contrast, prosecuting that litigation involved thousands of hours of effort over a period of six years.

[11] The class-action device is useful in this respect precisely because it facilitates "the spreading of litigation costs among numerous litigants with similar claims." *United States Parole Comm'n v. Geraghty*, 445 U.S. 388, 403 (1980).

market-remedy to which the United States is entitled, such a procedural obstacle will stand as a perpetual threat to the Federal Government's capital market, and a perpetual counter-incentive to the States, which are obliged to refrain from injuring that market.

3. Although required to vindicate the market interests of the United States at some unavoidable (but by no means prohibitive) cost to California, the court below enforced Section 19055 and thus reached a "result-oriented decision . . . for the purpose of protecting [the] State's coffers." *Sheehy v. Montana Dep't of Revenue*, 250 Mont. 437, 820 P.2d 1257, 1269 (1991) (Trieweiler, J., dissenting), *cert. granted, vacated and remanded*, 113 S. Ct. 3025 (1993). It ruled that no remedy was available to the thousands of California residents who were penalized for their investment in federal obligations because, in compliance with the Board's advice to be "patien[t]," they did not file timely notices of claim.[12] The filing of such claims was not necessary to put the Board on notice that these investors existed, and were entitled to refunds; its sole purpose, according to the Board, was to reduce the cost to the State of administering the refund.

Earlier, in *Woosley v. California*, 3 Cal. 4th 758, 838 P.2d 758, 13 Cal. Rptr. 2d 30 (1992), *cert. denied*, 113 S. Ct. 2416 (1993), the California Supreme Court had applied an analogous statute to deny a class remedy for a tax scheme that unlawfully discriminated against the owners of motor vehicles purchased outside of California. In *Woosley*, the State had (at least arguably) greater leeway to impose conditions on the federal remedy for its unlawful tax, because the tax there was unlawful solely because it was discriminatory, and not because it was imposed in violation of an

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[12] In many instances, no doubt, the amount at stake for an individual investor was so low as not to justify the time and expense of filing even a notice of claim or "written authorization." *See supra*, note 10. Finding that their investment rendered them liable to state tax, many such investors will simply have decided against investing in federal obligations in the future. Of course, their decision to drop out of the market is costly to the United States in the aggregate notwithstanding the small amount of their refund claims individually.

immunity expressly intended to protect the United States' treasury.[13]

Apparently emboldened by this Court's denial of *certiorari* in *Woosley* (see App. at A-8 - A-11 (citing and relying upon *Woosley*)), the court below has now gone the next step: it has applied California's notice-of-claim requirement to thwart market-wide relief where the State has directly enriched itself "at the expense of the federal treasury" (*Davis*, 489 U.S. at 815 n.4), despite the fact that the alleged $1 million administrative cost of remedying that encroachment will have *no* appreciable effect on the State's economic stability. In other words, by the simple expedient of altering its refund requirements, California has been rewarded with effective immunity from liability for the proceeds of an unquestionably improper tax[14] while the injury to the United States' capital market remains unredressed.

The decision below, if left to stand, threatens not only to leave that market injury unredressed, but also effectively to end private enforcement of immunity-doctrine rights, both in California and elsewhere. Because it is the only federal forum available to review the constitutional issues that arise in actions for the refund of a state tax,[15] this Court has "frequently . . . entertained cases [in which] a taxpayer who had brought a refund action in state court against the State asked us to reverse an adverse state judicial decision premised upon federal law." *McKesson*, 496 U.S. at 27 & n.8 (citing numerous cases). It should entertain this case because of its importance to the present and future well-being of the federal treasury.

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[13] Moreover, the aggregate cost of the refunds sought in *Woosley* could arguably have affected the State's financial stability. *See* 3 Cal. 4th at 766 (plaintiffs sought refunds in excess of $1 *billion*).

[14] *See supra*, note 2.

[15] Actions like this one generally must be brought in state court. *See Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 116 (1981); *see also* 28 U.S.C. § 1341 (tax injunction act); U.S. Const., amend. XI.

B. The Decision Below Conflicts With This Court's Intervening Decision In *Harper*.

1. If California can escape liability to the aggrieved taxpayers in this case, then any State, by enacting similar legislation,[16] can avoid providing relief to the federal retirees whose claims this Court addressed twice in four years, first in *Davis* and again, just last Term, in *Harper*. Such a result, however, would be plainly inconsistent with *Harper*'s emphatic holding that the fiscal interests of the offending State may not serve as a ground for denying refunds. The *Harper* Court rejected state fiscal interests in three different ways. First, in the face of arguments that " '[t]he fiscal implications of *Davis* for the [S]tates . . . are truly staggering' " (113 S. Ct. at 2535 (O'Connor, J., dissenting) (citation omitted)),[17] the Court held that *Davis* must be applied retroactively. 113 S. Ct. at 2518. Next, the Court specifically rejected Virginia's application of a state-law retroactivity doctrine which would have permitted consideration of its own fiscal interests,[18] stating: "[t]he Supremacy Clause . . . does not allow federal retroactivity

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[16] Several States have already followed California's lead in imposing disabling restrictions on the maintenance of class actions for tax refunds. *E.g.* Ind. Code Ann. §§ 6-6-1.1-910; 6-6-2.1-807 (enacted 1990); *id.* § 6-6-4.1-7.1 (1991); *id.* § 6-8.1-9-7 (1989); N.J. Stat. § 54:49-14 (1992) ("a refund claim on behalf of a class is not permitted"); S.C. Code Ann. § 12-47-447 (1991) (requiring tax commission to issue refund to only those similarly situated taxpayers "who properly have applied for a refund pursuant to the requirements of this chapter"). *See Dean v. State*, 250 Kan. 417, 423, 826 P.2d 1372, 1377, *cert. denied*, 112 S. Ct. 2941 (1992) (construing Kan. Stat. Ann. §§ 79-2005 & 74-2426 as precluding class remedy).

[17] Justice O'Connor noted that the States' estimated "total liability will exceed $1.8 billion." 113 S. Ct. at 2535.

[18] *See Harper v. Virginia Dep't of Taxation*, 241 Va. 232, 241-42, 401 S.E.2d 868, 873-74, *vacated*, 111 S. Ct. 2883 (1991) (state retroactivity doctrine considered, among other things, the State's "reliance on the old rule" and "the effect on the administration of justice of a retroactive application of the new rule") (citations omitted). Thus, the Virginia Supreme Court had justified its decision not to apply *Davis* retroactively in part on the ground that to do so would have a "potentially disruptive

doctrine to be supplanted by the invocation of a contrary approach to retroactivity under state law." *Id.* at 2519. Finally, in light of *Harper*, the Court vacated and remanded for reconsideration the decisions of no fewer than five state courts, each of which had justified its refusal to award refunds on the ground of the fiscal burden that making refunds would impose on the offending State.[19]

2. *Harper* left open only *one* potential state-law basis for the denial of the refunds the retirees sought. The challenged tax being discriminatory rather than "beyond the State's power to impose" under any circumstances, "federal law [did] not *necessarily* entitle [the retirees] to a refund." *Id.* at 2519 (emphasis added). In particular, if state law offered aggrieved taxpayers the opportunity to challenge the contested tax before they paid it, then *due*

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and destructive impact on the Commonwealth's planning, budgeting and delivery of state services." 241 Va. at 240, 401 S.E.2d at 873.

[19] In *Sheehy v. Montana Dep't of Revenue*, 250 Mont. 437, 820 P.2d 1257, 1262 (1991), *cert. granted, vacated and remanded*, 113 S. Ct. 3025 (1993), refunds were denied in part because of "the financial burden on the citizens of the State of Montana." In *Swanson v. State*, 329 N.C. 576, 583, 407 S.E.2d 791, 794 (1991), *reh'g granted*, 330 N.C. 390, 410 S.E.2d 490 (1991), *cert. granted, vacated and remanded*, 113 S. Ct. 3025 (1993), the state court took "judicial notice of the fact that this State is in dire financial straits," and noted that the requested refunds would cost "approximately $140,000,000.00." The court in *Duffy v. Wetzler*, 174 A.D.2d 253, 265, 579 N.Y.S.2d 684, 691 (N.Y. App. Div. 1992), *cert. granted, vacated and remanded*, 113 S. Ct. 3027 (1993), believed that "the State should not be required to refund an estimated $44,000,000, particularly in today's parlous fiscal circumstances." And in *Cambridge State Bank v. James*, 480 N.W.2d 647, 654-55 (Minn. 1992), *cert. granted, vacated and remanded*, 113 S. Ct. 3026 (1993), refunds were denied on the basis of "the state's equitable interests," by which the court meant "its potential liability." *See also Bass v. State*, 302 S.C. 250, 256, 395 S.E.2d 171, 174 (1990), *cert. granted, vacated and remanded*, 111 S. Ct. 2881 (1991), *on remand*, 307 S.C. 113, 414 S.E.2d 110 (1992), *cert. granted, vacated and remanded*, 113 S. Ct. 3025 (1993) (refunds "would impose a severe financial burden on the State and its citizens [and] endanger the financial integrity of the State").

process was satisfied. *Id.* Because the availability of a predeprivation remedy posed an issue of state law which had "not been properly presented," the Court remanded the case to the Virginia court to rule on that limited issue. *Id.* at 2520.

The tax challenged in *Harper* did not directly invade the federal treasury,[20] and the issue of the relief owing the United States did not arise there. Even so, it is significant that the *only* possible basis for the refusal to refund the unlawful tax that *Harper* left open to Virginia was one that grew out of that State's leeway in remedying discriminatory taxation schemes. The States have *no* remedial discretion when the property or instrumentality they have taxed enjoys federal immunity, as is the case here. *Harper*'s holding that the dictates of the Supremacy Clause may not be evaded on the basis of state fiscal interests (113 S. Ct. at 2519) perforce bars the application of a fiscal-based state law like Section 19055 when its purpose and effect is to deny complete market relief to the United States.[21]

The Board offered only one interest behind the Section 19055 amendments it drafted in the wake of *Brown*: the State's fiscal interest in reducing the administrative cost of making refunds. This fiscal interest, however, does not justify the failure to make the market whole by awarding refunds to substantially all aggrieved investors. It is axiomatic that California's fiscal interest in retaining the ill-gotten tax proceeds themselves provides no defense. *McKesson*, 496 U.S. at 50 ("the State's interest in financial

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[20] *But see Davis*, 489 U.S. at 815 n.4 (observing that discriminatory tax exemption for state retirees has an *indirect* fiscal "impact on the Federal Government").

[21] In a case like *Harper*, the State's remedial obligations are delimited by the Due Process Clause. In a case like this one, however, the Supremacy Clause commands an offending State to provide market-relief to the United States no less than the Due Process Clause commands it to provide adequate refund procedures to individual investors. Thus, whether or not a State's failure to provide class-wide relief offends the due process rights of individual investors, it will offend the Supremacy Clause whenever it results in a failure substantially to relieve the market injury that the United States has suffered.

stability does not justify a refusal to provide [the] relief" that federal law requires). But it is no different, either in concept or in practical effect, to assert its fiscal interest in not spending the money that it will cost to *administer* the refund remedy. The administrative cost the Board sought to avoid arose out of its need in *Brown* to "[1] identify the class, [2] notify and correspond with class members, [3] evaluate their claims, and [4] ultimately issue refunds." App. at A-18.[22] But the Board must take the latter three of these four steps *whenever* it is required to refund an illegal tax.[23] The cost of taking those steps cannot be distinguished from the cost of providing the remedy, nor the refusal to take those steps distinguished from the refusal to provide the remedy.

If the *interest* California asserts in enforcing amended Section 19055 in this case is insufficient under the Supremacy Clause, so is the apparent *purpose* of that Section: to refund as little of the illegal tax proceeds as possible. The Board expects significantly lower administrative costs to result from the requirement that every individual seeking relief file his or her own notice of claim because tens of thousands of individuals secured the federally-guaranteed refund of unlawful tax payments when class-wide relief was granted in *Brown*, while only a handful will do so in the absence of such relief in this successor to *Brown*. But making a mere handful of refunds will not repair the injury that California has done to the federal treasury.

3. Had this Court's decision in *Harper* been available at the time this matter was before the court below, that court would have been constrained to decide the federal question differently. *See Board of Trustees v. Sweeney*, 439 U.S. 24, 26 (1978) (Stevens, J., dissenting) (remand for reconsideration appropriate

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[22] *See also Woosley*, 3 Cal. 4th at 791 (amendment to Section 19055 intended "to spare the state the substantial administrative costs associated with identifying and notifying class members").

[23] While the Board contended that the aggregate cost of *all* of these steps in *Brown* exceeded $1 million, there is no evidence that the first step by itself—identifying the taxpayers entitled to refunds—cost the Board significant labor or expense. *See* App. at A-18.

where intervening decision of this Court "shed new light on the law which, if it had been available at the time of the court of appeal['s] decision, might have led to a different result").[24]

Even before *Harper*, of course, this Court's supremacy-clause jurisprudence was clear that the state courts may not apply a state law—not even a "neutral procedural rule[]" (*Howlett v. Rose*, 496 U.S. 356, 372 (1990))—that will "thwart [a] congressional remedy" (*Felder v. Casey*, 487 U.S. 131, 139 (1988)) or that otherwise "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Perez v. Campbell*, 402 U.S. 637, 649 (1971) (citation omitted). *Felder* is particularly instructive: in a state court action brought under 42 U.S.C. § 1983, the Court concluded that Wisconsin's notice-of-claim statute was preempted because it "conflict[ed] in both its purpose and effects with the remedial objectives of § 1983." 487 U.S. at 138. The "purpose" of the notice-of-claim statute in *Felder* was to "impose conditions [on suits against Wisconsin municipalities] that 'assis[t] municipalities in controlling [the] costs'" concomitant to liability, such as "defense costs." *Id.* at 143. This Court unequivocally rejected that purpose:

> "The decision to subject [municipalities] to liability for violations of federal rights . . . is a decision that the State has no authority to override. Thus, however understandable or laudable *the State's interest in controlling liability expenses might otherwise be, it is patently incompatible with the compensatory goals of the federal legislation* . . ." (*Id.* (emphasis added))

Felder's reasoning fits this case equally well: the sole purpose of California's notice-of-claim statute is to "control[] [the State's] liability expenses," and its practical effect is to deprive the United States of the remedy federal law provides for the injury that the unlawful tax has inflicted on its capital market.

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[24] The Iowa Supreme Court has already relied upon *Harper* in rejecting that State's attempt "to avoid its refund obligation by arguing the alleged inequity of imposing an onerous fiscal burden on the state . . . ." *Hagge v. Iowa Dep't of Revenue & Fin.*, 504 N.W.2d 448, 452 (Iowa 1993) (total liability of State exceeded $40 million).

Before *Harper*, however, the state courts regularly refused to apply *Felder*'s preemption analysis to state tax-refund procedures.[25] *Harper* now makes it clear that the Supremacy Clause carries no less force when it confronts a state tax-refund procedure designed to "control liability expenses" than in any other arena of state legislation, and that state fiscal justifications may no more trump a federal *tax* remedy than they may any other remedy federal law provides.

Section 19055's thinly-veiled disavowal of the federal market remedy is plainly invalid under *Harper* and *Felder* because it subordinates the fiscal interests of the United States to those of the State; it is nothing less than California's roundabout declaration of its "disagree[ment] with the content of federal law." *Howlett*, 496 U.S. at 379. The Supremacy Clause does not allow the fiscal interests of the United States to be supplanted by the invocation of state fiscal interests. *See Harper*, 113 S. Ct. at 2519. The application of Section 19055 in the court below has done precisely the same mischief as the state courts in *Harper, Sheehy, Swanson, Duffy, Cambridge,* and *Bass* attempted to do: it has defeated the remedy that federal law requires for unconstitutional state taxation on the basis of contrary state fiscal interests. The only significant difference between those cases and this one is that the federal interest here requires the State to provide relief not only to the individuals subjected to the unlawful tax, but also

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[25] *E.g., Hogan v. Musolf*, 163 Wis. 2d 1, 15, 471 N.W.2d 216, 221 (1991), *cert. denied*, 112 S. Ct. 867 (1992); *Nutbrown v. Munn*, 311 Or. 328, 337-43, 811 P.2d 131, 136-39 (1991), *cert. denied*, 112 S. Ct. 867 (1992); *Zarda v. State*, 250 Kan. 364, 372-73, 826 P.2d 1365, 1371-72, *cert. denied*, 112 S. Ct. 2941 (1992). *See also State v. Quill Corp.*, 500 N.W.2d 196, 202 (N.D.), *cert. denied*, 114 S. Ct. 173 (1993). These courts relied on *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100 (1981), in which this Court held that principles of comity prevented *federal* courts from awarding state tax refunds where the State provided a "plain, adequate and complete" remedy. Stretching *McNary*'s rationale, and confusing the due process issue with the preemption issue, these courts concluded that *state* courts in actions for the refund of unconstitutional taxes could require the exhaustion of even those remedies which, under *Felder*'s analysis, would be preempted.

to the Federal Government's financial market, at the expense of which the State has enriched itself.[26] Because it is inconsistent with *Harper*, the decision below should not be permitted to stand.

4. Finally, the decision below is doubly offensive to the Supremacy Clause because the rule of state law on the basis of which it deprives the United States and its investors of their remedy is one that the State announced for the first time *after* it collected the unlawful tax. A state-law ground for the denial of a federal claim is impermissible as a matter of federal law when it originates in the context of the State's attempt to shield itself from liability on that very federal claim.

The Court in *McKesson* expressed precisely this point when it observed that a State may refuse to refund an unconstitutional tax to a taxpayer who has failed to comply with a notice requirement, provided that the requirement "was in effect at the time of [his or her] tax payments." 496 U.S. at 24 n.4. *See also id.* at 50 ("in the *future*, States may avail themselves of a variety of procedural protections against any disruptive effects of a tax scheme's invali-

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[26] Even before *Harper*, at least one state court had recognized its duty to provide class-wide refunds notwithstanding state-law barriers to a class-wide remedy. *Sizemore v. Rinehart*, 611 So. 2d 1064 (Ala. Cir. App. 1992), *writ quashed*, 611 So. 2d 1069 (Ala. 1993), was a *Davis*-type action seeking some $20 million in refunds. The trial court certified a class of retirees and granted relief. The Court of Civil Appeals affirmed, rejecting without discussion the argument of the revenue commissioner that class actions against the State were barred by Section 14 of the Alabama Constitution. After hearing oral argument, the Alabama Supreme Court quashed its writ of *certiorari* as improvidently granted. 611 So. 2d at 1070. The lone dissent, framing the issue as whether the Supremacy Clause stood in the way of the enforcement of the Alabama Constitution (*id.* at 1071), argued that it did not. *Id.* at 1074. ("The mere fact that the state did not provide a class action procedure to challenge this income tax . . . does not make the state tax procedures constitutionally inadequate" under federal law). The result was that Alabama was required to provide the federal remedy on a class-wide basis in the face of a formidable state-law obstacle—its state constitution—even though its unlawful tax had no direct impact on the federal treasury.

dation") (emphasis added). While *McKesson* upheld the taxpayer's right to a "backward looking" remedy on due process grounds (*id.* at 51-52), its dictum on retroactive procedures stems, at least in part, from the Supremacy Clause. Due process is not offended by retroactive state tax legislation reasonably imposed. *E.g. Welch v. Henry*, 305 U.S. 134, 146 (1938) (citing *Milliken v. United States*, 283 U.S. 15, 21 (1931)). But the Supremacy Clause is peculiarly implicated when a *State* imposes a rule that is specifically intended to restrict a *federal* tax remedy. This is all the more so when that federal remedy is intended to provide relief for an injury to the United States itself.

At the time that the tax here at issue was collected—1982 through 1985—it was well settled as a matter of California law that administrative claims could be filed by a single claimant on behalf of an absent class.[27] The Board concedes that its motive in proposing legislation to change this rule was nothing more nor less than a desire to escape the expense to which it had been put in making refunds of the unconstitutional tax it had collected between 1978 and 1981. App. at A-17 - A-18. The California Legislature enacted the Board's amendment, making it effective in 1986. The court below then applied the amended statute as the basis for denying class relief to taxpayers from whom the Board had collected the unconstitutional tax in the four tax years *prior* to 1986. Because the amended statute was not "in effect at the time of [the] tax payments" the class seeks to recover (*McKesson*, 496 U.S. at 24 n.4), it may not be applied in this action. California may not evade "the force of the Supremacy Clause" (*Howlett*, 496 U.S. at 382-83) by imposing this new state-law obstacle with the express purpose of frustrating the market relief that federal law requires.

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[27] *E.g. City of San Jose v. Superior Court*, 12 Cal. 3d 447, 454-58, 525 P.2d 701, 115 Cal. Rptr. 797 (1974); *Schoderbek v. Carlson*, 113 Cal. App. 3d 1029, 1033-37, 170 Cal. Rptr. 400 (1980); *Lattin v. Franchise Tax Bd.*, 75 Cal. App. 3d 377, 380-83, 142 Cal. Rptr. 130 (1977); *Santa Barbara Optical Co. v. State Bd. of Equalization*, 47 Cal. App. 3d 244, 247-51, 120 Cal. Rptr. 609 (1975).

CONCLUSION

For all the foregoing reasons, the petition for writ of certiorari should be granted.

DATED: November 12, 1993.

Respectfully,

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FILED

APR 22, 1993

Court of Appeal—First App. Dist.

By RON D. BARROW
Deputy

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

DONALD E. FARRAR et al.,
Plaintiffs and Appellants,

v.

FRANCHISE TAX BOARD
Defendant and Respondent.

A056762

(San Francisco Super. Ct. No. 890858)

Revenue and Taxation Code[1] section 19055 provides that an administrative claim for refund of income taxes when "filed for or on behalf of a class of taxpayers shall do all of the following: [¶] (a) Be accompanied by written authorization from each taxpayer sought to be included in the class. [¶] (b) Be signed by each taxpayer or taxpayer's authorized representative. [¶] (c) State the specific grounds on which the claim is founded."

This appeal from an order refusing to certify a class action seeking a judicial refund of taxes collected by the Franchise Tax Board (Board) presents the issue of whether section 19055 means what it says. We hold that it does and that it is to be enforced on

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[1] Subsequent statutory references are to this Code unless otherwise indicated.

that basis. We further hold that would-be representatives who fail to take section 19055 at face value cannot invoke the doctrine of substantial compliance otherwise applicable to class actions.

BACKGROUND

In a very real sense, it all began with Sandra Brown. It was she who in the early 1980s instituted a class action for refund of income taxes the Board had assessed and collected on dividends paid to class members by a trio of mutual funds for the tax years 1978, 1979, 1980, and 1981. She claimed that the Board had no power to tax the dividends because they derived from—and thus in legal effect were-nontaxable obligations of the federal government. The trial court sustained this claim, certified the class, and ordered the Board to provide notice to the members of the class identified from the funds' records.

Approximately 40,000 claims were received and allowed by the Board. The ensuing judgment ordering refunds of almost $6 million plus substantial interest was affirmed by this court in December of 1987. (*Brown v. Franchise Tax Bd.* (1987) 197 Cal.App.3d 300.)[2]

Several very relevant events occurred during the pendency of the *Brown* litigation. First, having incurred extraordinary and unanticipated expenses of more than $1 million, the Board drafted amendments to section 19055 which the Legislature enacted and which became effective in September of 1986.[3] (See note 8,

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[2] Our affirmance also reached the procedure established by the trial court to deal with the 3,000 or so disputed claims disallowed by the Board.

[3] Prior to the amendment section 19055 provided: "Every claim for refund shall be in writing and shall state the specific grounds upon which it is founded." (See Stats. 1945, ch. 645, § 110, p. 1289.)

After amendment section 19055 now provides: "Every claim for refund shall be in writing, shall be signed by the taxpayer or the taxpayer's authorized representative, and shall state the specific grounds upon which it is founded. A claim filed for or on behalf of a class of taxpayers shall do all of the following: [¶] (a) Be accompanied by

post.) Second, in April of the following year, the administrative preliminaries to this case commenced when plaintiffs Donald and Joan Farrar filed a joint claim for refund of taxes they paid on dividends from the same three funds involved in *Brown*; plaintiffs' claim picked up where Sandra Brown's claim ended—with the tax year 1982—and extended through the three succeeding years. Mr. Farrar purported to make the claim as a class representative for all persons who paid California income tax on the dividends from the funds.

Hearing nothing from the Board, plaintiffs deemed their claim disallowed (see § 19085) and commenced this action in April of 1988. Plaintiff Donald Farrar identified himself in the complaint as suing "individually and on behalf of all others similarly situated." Plaintiffs alleged that the Board's continued collection of tax on dividends from federal government obligations violated a host of state and federal constitutional and statutory provisions. The Board's silence ended in late June of 1988—about the time our decision in *Brown* became final—when it answered plaintiffs' complaint and asserted for the first time that plaintiffs' administrative claim did not comply with section 19055.

Plaintiffs thereafter submitted five "supplements" to their administrative claim with more than 600 written authorizations from other taxpayers purporting to designate plaintiffs to prosecute the action on their behalf. The Board responded by informing plaintiffs in effect that (1) exclusive jurisdiction over plaintiffs' claim was now with the court[4] (2) the authorizations were invalid because they had not been filed with, and "cannot retroactively cure the defects" in plaintiffs' administrative claim, and (3) each of the authorizations was "considered to be a new

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written authorization from each taxpayer sought to be included in the class. [¶] (b) Be signed by each taxpayer or taxpayer's authorized representative. [¶] (c) State the specific grounds on which the claim is founded." (Stats. 1986, ch. 931, § 4, p. 3225.)

[4] The Board stated that it was nevertheless "subject to the court's approval, . . . willing to grant the claims of Donald E. and Joan F. Farrar, *as individuals*, but not as representatives of any class, for refund of tax paid on distributions" from two of the funds. (Original emphasis.)

claim" that was untimely because "[t]he limitations period for filing such claims, prescribed by . . . Section 19053, has expired."

Plaintiffs then moved for certification of a class and two subclasses defined so as to "include all [individual and corporate] investors who paid California tax on distributions from the Funds in the relevant years irrespective of whether the investors brought individual claims for refunds."[5] The trial court denied the motion, concluding that "plaintiffs have failed to meet the class claim filing requirements of . . . Section 19055" and "in view of that statute, and how specific it is, there was not substantial compliance."

Plaintiffs perfected a valid appeal from the formal order denying their motion.[6]

REVIEW

Both sides have throughout this litigation received exceptionally competent representation. Fresh from her triumph in *Brown*, plaintiff's counsel is understandably anxious to achieve a similar victory by establishing that the investment dividends on her actual and putative clients are beyond the Board's taxable domain. That far we need not go, for the dispositive issues on this appeal are purely procedural.

The progression of plaintiffs' arguments runs as follows: First, relying on the proposition stated by our Supreme Court that administrative claims statutes were not intended to "thwart class relief" (*City of San Jose v. Superior Court* (1974) 12 Cal.3d 447, 457), plaintiffs urge that section 19055 be given a construction that will avert such a result. Second, they submit that section 19055 and 19085 should not be read as permitting the Board to

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[5] Plaintiffs advised the trial court that the anticipated size of the class could be as high as 90,000.

All of the taxpayers identified in the supplements to plaintiffs' refund claim before the Board were individuals.

[6] The order is appealable. (*Richmond v. Dart Industries, Inc.* (1981) 29 Cal.3d 462, 470.)

"sandbag" the unwary by waiting until the administrative process is concluded and judicial proceedings begun before raising a defect in the form of the administrative claim. Third, they contend that the class claim they filed with the Board should be treated as adequate for purposes of section 19055 by application of the doctrine of substantial compliance adopted in *City of San Jose* and subsequent decisions. Finally, plaintiffs urge that ratification of the construction given section 19055 by the Board and the trial court would allow a taxing practice prohibited by federal law (31 U.S.C. § 3124) and our *Brown* decision to go unchecked, thereby violating the Supremacy Clause of article VI of the United States Constitution.

The well-known advantages of the class action are convenience, efficiency, and completeness. (E.g., *Richmond v. Dart Industries, Inc., supra,* 29 Cal.3d 462, at p. 469; *Vasquez v. Superior Court* (1971) 4 Cal.3d 800, 807-808.) Its general but limited codification in Code of Civil Procedure section 382[7] notwithstanding, the class action retains the essence of its origins as an invention of equity. (*See City of San Jose v. Superior Court, supra,* 12 Cal.3d 447 at pp. 458, 463; *Hansberry v. Lee* (1940) 311 U.S. 32, 41; *Supreme Tribe of Ben-Hur v. Cauble* (1921) 255 U.S. 356, 363, 366; Note, *Class Actions and Interpleader: California Procedure and the Federal Rules* (1953) 6 Stan. L. Rev. 120, 121-123.) Our Supreme Court has reinforced this heritage by urging trial courts to adopt flexible and innovative procedures from common law sources and analogous statutes. (*See Richmond v. Dart Industries, Inc., supra,* at pp. 469-470, fn. 7; *Vasquez v. Superior Court, supra,* at pp. 820-821.)

In light of the fact that the class action remedy continues to be essentially equitable in nature, and given that equity will defer to statute, the common law features of class action administration are subject to legislative displacement. (*See City of South San*

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[7] Whose relevant language provides that "when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all." (See also Civ. Code, § 1781.)

Francisco v. Cypress Lawn Cemetery Assn. (1992) 11 Cal.App.4th 916, 922-923; *Johnson v. Tago, Inc.* (1986) 188 Cal.App.3d 507, 518.) Section 19055 is a statute that is recent in origin, unambiguous in phrasing, and specific in the scope of its application. It therefore is to be accepted as stating the governing rule of decision and to be applied according to its plain language. (*Great Lakes Properties, Inc. v. City of El Segundo* (1977) 19 Cal.3d 152, 155.)

That plain language does not evidence any legislative intent to thwart class relief for tax refunds. On the contrary, section 19055 reflects the Legislature's express sanction for class actions. All that section 19055 does is establish conditions to the availability of that remedy. With the exception of their Supremacy Clause argument, plaintiffs raise no challenge to the Legislature's power to impose such conditions.

Plaintiff's second point requires that section 19055 be considered in conjunction with section 19085, which provides in pertinent part: "If the . . . Board fails to mail notice of action on any refund claim within six months after the claim was filed, the taxpayer may, prior to mailing of notice of action on the refund claim, consider the claim disallowed and bring an action against the . . . Board on the grounds set forth in the claim for recovery of the whole or any part of the amount claimed . . . ."

Section 19085 is obviously designed to provide a measure of certainty and protection to both taxpayers and the Board. By requiring the taxpayer to state the grounds for a refund claim, section 19085 gives the Board notice of the claim and the underlying substantive reasons. If, for whatever reason, the Board takes no action on the claim, the Board knows what it will confront if the taxpayer initiates a judicial action for a refund. On the other hand, the taxpayer is given a clear timetable for commencing judicial action instead of endlessly wondering if an administrative refund claim has been lost down a bureaucratic rathole. (Cf. *Shell Western E & P, Inc. v. County of Lake* (1990) 224 Cal.App.3d 974, 984-985.)

Plaintiffs appear to believe that section 19085 somehow obliges the Board to notify a taxpayer of any defect in the form of an

administrative claim in order to preserve the defect as an issue in subsequent court action. In other words, the Board is not required to respond to the substantive merits of the claim but, on penalty of forfeiting the issue, the Board is required to point out defects in the form of the claim. This conjures up the bewildering possibility of the Board telling a taxpayer "Your claim is not in the correct form, but don't assume that our telling you about this problem means we will make a decision on your claim if you correct the problem."

Any possible merit to plaintiffs' position is obliterated by the indisputable fact that plaintiffs made no real attempt to comply with section 19055 until after they commenced this action, which was 17 months after the amended version of that statute took effect. For 12 of those 17 months plaintiffs were represented by counsel who would have particular reason to know that section 19055 had been amended, because it was that counsel's success in the Brown litigation which was a proximate cause of the statute's revision. Actual as well as imputed or constructive knowledge is shown by plaintiffs' identifying their administrative claim as being on behalf of a class, a requirement of the amended section 19055 not present in its original form. (See note 3, *ante.*) But beyond this plaintiffs made not even a perfunctory effort to comply with the more detailed requirements specified by section 19055 for a class claim.

Plaintiffs' argument that something akin to a waiver or estoppel results from the Board not invoking section 19055 earlier is also defeated by constitutional considerations. Article XIII, section 32 of the California Constitution specifies that "After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature." In light of our Supreme Court's acceptance that this provision "means what it says" (*Pacific Gas & Electric Co. v. State Bd. of Equalization* (1980) 27 Cal.3d 277, 284), courts of appeal have held that they "are without authority to alter the statutory procedures for tax refunds enacted by the Legislature pursuant to the . . . command of article XIII, section 32." (*Shiseido Cosmetics (America) Ltd. v. Franchise State Bd.* (1991) 235 Cal.App.3d 478, 486-489; accord *Masi v. Nagle*

(1992) 5 Cal.App.4th 608, 611-612; *Patane v. Kiddoo* (1985) 167 Cal.App.3d 1207, 1214.)

The recent validation of this approach by our Supreme Court dooms plaintiffs' third argument—that their purported class action may go forward under the substantial compliance doctrine of *City of San Jose v. Superior Court, supra,* 12 Cal.3d 447. There the Court held that to satisfy the administrative claim provision of the Government Torts Claims Act (Gov. Code, § 810 et seq., esp. § 910) "the class claim must provide . . . specified information concerning the representative plaintiff and then sufficient information to identify and make ascertainable the class itself. . . . Beyond this, the sufficiency of the identifying information must be measured by the substantial compliance test." (*City of San Jose v. Superior Court, supra,* at p. 457 [original emphasis omitted].) A number of Court of Appeal decisions extended this reasoning to class claims for tax refunds. (See e.g., *Schoderbek v. Carlson* (1980) 113 Cal.App.3d 1029; *Lattin v. Franchise Tax Board (1977) 75 Cal.App.3d 377; Santa Barbara Optical Co. v. State Bd. of Equalization* (1975) 47 Cal.App.3d 244.) This trend was halted in *Woosley v. State of California* (1992) 3 Cal.4th 758.

Woosley involved a class action challenging the imposition of certain license fees and use taxes. Woosley filed an administrative refund claim on behalf of himself and all others similarly situated. The claim was denied, whereupon Woosley commenced a successful class action for refund. On its own initiative the Supreme Court raised and considered the issue of the adequacy of the class claim, concluding that the substantial compliance portion of *City of San Jose* "should not be extended to include claims for tax refunds." (*Woosley v. State of California, supra,* 3 Cal.4th 758 at pp. 788-789.)

With respect to the statute governing use tax refund claims, the Court stated: "When Woosley filed his claim in 1977, section 6904 read: 'Every claim shall be in writing and shall state the specific grounds upon which the claim is founded.' In 1987, approximately 10 years after Woosley filed his claim, the Legislature amended section 6904 to add the following language . . . : 'A claim filed for or on behalf of a class of taxpayers shall do all of the following: [¶] (1) Be accompanied by written authorization

from each taxpayer sought to be included in the class. [¶] (2) Be signed by each taxpayer or taxpayer's authorized representative. [¶] (3) State the specific grounds on which the claim is founded.' (Stats. 1987, ch. 38, Section 5, p. 101.) [¶] The statute as amended in 1987 expressly permits, for the first time, the filing of a class claim, but requires that each member of the class authorize his or her inclusion in the class and that each member of the class, or the class member's authorized representative, sign the claim. A class claim for refund of sales and use taxes may not be submitted, as it was in the present case, without the knowledge and express consent of each member of the class." (*Woosley v. State of California, supra,* 3 Cal.4th 758 at p. 791.) Noting that in 1986 "the Legislature had amended section 19055, governing claims for refunds of personal income taxes, and section 26074, governing claims for refunds of bank and corporate taxes, to add language nearly identical to that later added to section 6904," the Court construed these amendments as evidencing the Legislature's aim "to allow a narrowly circumscribed form of class claims," specifically, "only those class claims where each member of the class expressly authorizes and signs the claim."[8] (*Id.* at pp. 791-792.) Disapproving the line of Court of Appeal decisions allowing class claims, the Court concluded that "article XIII, section 32 of the California Constitution precludes this court from expanding the methods for seeking tax refunds expressly provided by the Legislature." (*Id.* at p. 792.)

Plaintiffs argue in a supplemental brief that *Woosley*—which was decided during the pendency of this appeal—is dicta on the issue of the construction of section 19055. Strictly speaking, plaintiffs may be correct. But as *Woosley* did construe a statute characterized as "nearly identical" to section 19055, the discussion of the *in pari materia* section 6904 is clearly germane for present purposes. (See *In re Phyle* (1947) 30 Cal.2d 838, 845; *Security Pacific Nat. Bank v. Casavant* (1988) 205 Cal.App.3d

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[8] The Court further noted that these amendments "were intended to spare the state the substantial administrative costs associated with identifying and notifying class members once a case had been certified as a class action." (*Woosley v. State of California, supra,* 3 Cal.4th 758 at p. 791.)

127, 130.) If *Woosley* is dicta, it has an especially muscular nature and relevancy. The lesson of *Woosley* we take to be that statutes governing administrative tax refund procedures, backed as they are by a plenary constitutional authority, are to be strictly enforced.[9] (See also *Barclays Bank Internat. Ltd. v. Franchise Tax Bd.* (1992) 10 Cal.App.4th 1742, 1749.)

In any event, the Court has held that the doctrine of substantial compliance kicks in only after the aspiring class representative plaintiff establishes "*some* compliance with *all* of the statutory requirements." (*City of San Jose v. Superior Court, supra,* 12 Cal.3d 447 at pp. 456-457 [original emphasis].) By any stretch of the imagination, plaintiffs cannot demonstrate any pretense of timely compliance with the written authorizations requirement section 19055 demands of all members of a class refund claim. The inescapable consequence of plaintiffs' noncompliance is that their administrative claim was, and their refund action is, valid only as to them in their individual capacities. (See *Woosley v. State of California, supra,* 3 Cal.4th 758 at p. 788.)

Plaintiff's final argument looks to avoid all of the foregoing by interposing the Supremacy Clause. Again, plaintiffs are looking ahead to the merits of their substantive attack on the tax. As we have just concluded, plaintiffs are properly in court and able to make that attack on their own behalf. But insofar as they are forced to go it alone, they are not aggrieved or hindered in that quest by the absence of a class behind them. (Cf. *County of Alameda v. Carleson* (1971) 5 Cal.3d 730, 737.) Nothing in the Supremacy Clause requires them to be generals at the head of an army. Moreover, the United States Supreme Court has held that a state may, consistent with constitutional demands, ensure its "exceedingly strong interest in financial stability" by enacting a variety of procedural protections, among which are "timely notice

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[9] As this court has particular reason to know, two months after *Woosley* the Supreme Court made it clear that it takes an equally dim view of attempts by the state to avoid strict compliance with the administrative machinery established by statute to consider refund claims. (See *Title Ins. Co. v. Bd. of Equalization* (1992) 4 Cal.4th 715, 729-730.)

of complaint" provisions and "relatively short statutes of limitations." (*McKesson Corp. v. Florida Alcohol & Tobacco Div.* (1990) 496 U.S. 18, 37, 45.) This is the net effect of the provisions considered here; plaintiffs did not provide timely notice of a class claim in compliance with section 19055, and, when they took advantage of section 19085 to go into court, they deprived themselves of the ability to correct any defects in their administrative claim.

In sum, the trial court correctly recognized that plaintiffs had not complied with the plain language of section 19055, and that no federal constitutional consideration existed to enforcing compliance with that plain language. Denial of plaintiffs' certification motion was therefore not error.

The order is affirmed.

Perley, J.

We concur:

Anderson, P.J.

Reardon, J.

FILED

San Francisco County Superior Court

Feb. 18, 1992

Mita Money, Clerk

By Rob Suma
Deputy Clerk

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Franchise Tax Board

IN THE SUPERIOR COURT
OF THE STATE OF CALIFORNIA

FOR THE CITY AND COUNTY OF SAN FRANCISCO

DONALD E. FARRAR,
individually and on behalf of all others similarly situated, et al.,
Plaintiffs,

v.

FRANCHISE TAX BOARD,
Defendant.

No. 890858

CLASS ACTION

ORDER DENYING MOTION TO CERTIFY CLASS

The matter of Plaintiffs' Second Motion to Certify Class and Resolve Class Issues filed herein, came on regularly for hearing in the above-entitled Court on January 24, 1992, before the Honorable Lucy McCabe.

The Court having read and considered all of the pleadings and evidence before it and the argument of counsel, the Court finds that plaintiffs have failed to meet the class claim filing requirements of Revenue and Taxation Code Section 19055. The Court further finds that the evidence submitted by Plaintiffs does not support their theory of equitable estoppel.

GOOD CAUSE APPEARING, IT IS HEREBY ORDERED that the the [sic] Plaintiffs' Second Motion to Certify Class and Resolve Class Issues is denied.

DATED: February 14, 1992.

/s/ Lucy Kelly McCabe
Judge of the Superior Court

/s/ Elizabeth S. Salveson

Approved as to form:

ELIZABETH SALVESON
HOWARD, RICE, NEMEROVSKI,
CANADY, ROBERTSON & FALK

Attorneys for Plaintiffs

FILED

San Francisco County Superior Court

NOV 13, 1990

Donald W. Dickinson, Clerk

BY Jennifer Musk
DEPUTY CLERK

CALIFORNIA SUPERIOR COURT

CITY AND COUNTY OF SAN FRANCISCO

DEPARTMENT NUMBER NINE

DONALD E. FARRAR,
individually and on behalf of all others similarly situated,
Plaintiffs,

vs.

Franchise Tax Board,
Defendant

No. 890-858

ORDER DENYING MOTION
TO CERTIFY CLASS

Plaintiffs' motion to certify class and to resolve class issues, heretofore submitted, is denied without prejudice.

November 9, 1990

/s/ Ira A. Brown
IRA A. BROWN, JR.
Judge of the Superior Court

SUPREME COURT

FILED

July 15, 1993

Robert Wandruff Clerk
DEPUTY

First Appellate District, Division Four, No. A056762
S033112

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

DONALD E. FARRAR Et Al.,
Appellants

v.

FRANCHISE TAX BOARD,
Respondent

Appellants' petition for review DENIED.

Mosk, J. is of the opinion the petition should be granted.

LUCAS
Chief Justice

Supreme Court of the United States

No. A-304

Donald E. Farrar, et ux.,
Petitioners

v.

Franchise Tax Board

ORDER

UPON CONSIDERATION of the application of counsel for the petitioners,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled case, be and the same is hereby, extended to and including November 12, 1993.

/s/ Sandra D. O'Connor
Associate Justice of the Supreme
Court of the United States

Dated this 5th
day of October, 1993.

FILED
San Francisco County Superior Court
AUG 13, 1990
Donald W. Dickinson, Clerk
BY S. Douglas
DEPUTY CLERK

SUPERIOR COURT OF THE STATE OF CALIFORNIA

CITY AND COUNTY OF SAN FRANCISCO

DONALD E. FARRAR,
Individually and on behalf of all others similarly situated, et al.,
Plaintiffs,

v.

FRANCHISE TAX BOARD,
Defendant.

No. 890858

CLASS ACTION

DECLARATION OF DAVID HINMAN IN OPPOSTION TO MOTION TO CERTIFY CLASS AND TO RESOLVE CLASS ISSUES

Date: Sept. 24, 1990
Time: 9:30 a.m.
Dept.: 9 (Room 457)
Judge: Ira A. Brown

I, DAVID HINMAN, declare as follows:

1. I am a Senior Staff Counsel, Specialist for the Franchise Tax Board (Board).

2. I coordinated the department's efforts in *Brown v. Franchise Tax Board* (S.F. Superior Court No. 803759).

3. In the course of resolving the class action against the Board in *Brown,* the Board was required to expend an extraordinary amount of administrative effort and expense (which was not

(2)

FILED
DEC 9 1993
OFFICE OF THE CLERK

No. 93-788

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

DONALD E. FARRAR, et al.,
Petitioners,

vs.

FRANCHISE TAX BOARD,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, FIRST DISTRICT

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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BEST AVAILABLE COPY

QUESTION PRESENTED

Is the California Court of Appeal's holding that the class claim filing requirements of Revenue and Taxation Code section 19055 must be strictly enforced and that petitioners' failure to comply with such requirements precludes certification of a class action for refund of taxes in this case, an independent and constitutionally adequate state ground?

PARTIES TO THE PROCEEDING

Petitioners are Donald Farrar and his wife, Joan Farrar. Respondent is the Franchise Tax Board, an agency of the State of California.

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No. 93-788

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

DONALD E. FARRAR, et al.,
Petitioners,

vs.

FRANCHISE TAX BOARD,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL FIRST APPELLATE DISTRICT, DIVISION FOUR

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JURISDICTION

Petitioners invoke jurisdiction under 28 U.S.C. § 1257(a). Respondent Franchise Tax Board asserts that there is no jurisdiction because the California holding challenged by the petition is an independent and adequate state ground.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The United States Constitution, article VI, clause 2 ("Supremacy Clause") provides, in pertinent part:

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

2. 31 U.S.C. Section 3124(a) provides, in pertinent part:

> "Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax. . . ."

3. The California Constitution, article XIII, section 32 provides:

> "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature."

4. California Revenue and Taxation Code section 19055, as amended in 1986, provides, in its entirety:

> "Every claim for a refund shall be in writing, shall be signed by the taxpayer or the taxpayer's authorized representative, and shall state the specific grounds

upon which it is founded. A claim filed for or on behalf of a class of taxpayers shall do all of the following:

"(a) Be accompanied by written authorization from each taxpayer sought to be included in the class.

"(b) Be signed by each taxpayer or taxpayer's authorized representative.

"(c) State the specific grounds on which the claim is founded."

SUPPLEMENTAL STATEMENT OF THE CASE

Petitioners repeatedly make assertions in their Statement of the Case and in the body of the petition for writ of certiorari, that have no basis in the record and are contrary to the specific factual findings of the trial court below. The substance of those erroneous assertions is that the Franchise Tax Board [hereinafter, "Board"] took affirmative steps to impede and "discourage refund claims for the post-1981 tax years." (See Petition, pages 4-5.) In order to clarify the record and rectify petitioners' misstatements, respondent provides the following factual background of this case.

The petition seeks review of the Court of Appeal's decision which affirmed the lower court's refusal to certify a class action seeking a judicial refund of income taxes collected by the Board. In so affirming, the Court of Appeal held that the plain language of Revenue and Taxation Code section 19055, which sets forth mandatory class claim filing requirements (such as written authorization from each taxpayer sought to be included in the class and the signature of each such taxpayer or his or

her authorized representative) as a prerequisite to filing a class action lawsuit to obtain tax refunds, "means what it says" and that it should be enforced on that basis.[1/] (Petition, A-1.) The Court of Appeal held that "would-be representatives who fail to take section 19055 at face value cannot invoke the doctrine of substantial compliance otherwise applicable to class actions." (Petition, A-2.) The appellate court found that petitioners "made no real attempt to comply with section 19055 until after they commenced [their refund] action." (Petition, A-7.) The court further found that the class claim filing requirements of Section 19055 are consistent with the type of procedural protections permitted by this Court in *McKesson Corp.* v. *Florida Alcohol & Tobacco Div.*, 496 U.S. 18 (1990).

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1. All section references hereinafter refer to the California Revenue and Taxation Code unless otherwise indicated.

Prior to the 1986 amendment, Section 19055 provided that "[e]very claim for refund shall be in writing and shall state the specific grounds upon which it is founded."

Section 19055 subsequently was amended in 1986 to read as follows:

> "19055. Every claim for refund shall be in writing, shall be signed by the taxpayer or the taxpayer's authorized representative, and shall state the specific grounds upon which it is founded. A claim filed for or on behalf of a class of taxpayers shall do all of the following:
>
> (a) Be accompanied by written authorization from each taxpayer sought to be included in the class.
>
> (b) Be signed by each taxpayer or taxpayer's authorized representative.
>
> (c) State the specific grounds on which the claim is founded."

Petitioners misstate the record in asserting that the Board actively deterred taxpayers from filing individual claims for refund and then delayed in complying with the ruling in *Brown v. Franchise Tax Board*, 197 Cal.App.3d 300 (1987), until after the limitations period for individual claims had expired for two of the four tax years at issue. The purported basis of this assertion is the language of the Board's Public Service Bulletin No. 85-2, which petitioners quote in part at page 4 of the Petition (referred to as "an internal bulletin"). (See Respondent's Appendix, B-1.) Petitioners claim that by this internal bulletin the Board instructed its employees to misinform and mislead inquiring taxpayers regarding the need to file a timely claim for refund with respect to tax years later than those at issue in *Brown*. According to petitioners, the Board sought to misinform taxpayers that they should be patient until the *Brown* case was finally resolved so that claims for refund for later tax years would be time barred.

This hardly was the case. The Board established that the language from Public Service Bulletin 85-2 quoted by petitioners referred to the recommended response that Board employees should give to taxpayers inquiring about their claims for refunds already pending before the Board which involved the same issues raised in the *Brown* case. The bulletin did not refer to potential claims for refund which had not yet been filed. There was no plot to thwart taxpayers' claims for refund. The trial court specifically found that there was no evidence to support petitioner's equitable estoppel theory.

Petitioners misstate the record in claiming that "thousands of California residents . . . were penalized for their investment in federal obligations because, in compliance with the Board's advice to be 'patien[t],' they did not file timely notices of claim." (Petition, p. 12, ¶ 3.)

Petitioners submitted no evidence of any taxpayer being misled in this regard.

Further, petitioners erroneously assert that the Board persuaded the California Legislature to amend the claim filing requirements of Section 19055 in order to discourage refund claims for the post-1981 tax years. (Petition, p. 5.) Division Four of the First Appellate District Court of Appeal of the State of California noted in its decision in this case that the amendment to Section 19055 adding class claim filing requirements was drafted by the Board and enacted by the Legislature after the Board had "incurred extraordinary and unanticipated expenses of more than $1 million" in administering the *Brown* class action. (Petition, A-2.) Rather than finding any legislative intent to thwart class relief for tax refunds, the appellate court found that "section 19055 reflects the Legislature's express sanction for class actions." (Petition, A-6.) Thus, the 1986 amendment to Section 19055 for the first time allowed the filing of a class claim for tax refund where, as authoritatively determined (contrary to *Brown*) by the California Supreme Court, none had previously been permitted. (*Woosley v. State of California* 3 Cal.4th 758, 791-792, *cert. denied*, 113 S. Ct. 2416 (1992).)

ARGUMENT

THE COURT OF APPEAL'S HOLDING THAT THE CLASS CLAIM FILING REQUIREMENTS OF REVENUE AND TAXATION CODE SECTION 19055 ARE MANDATORY AND MUST BE STRICTLY ENFORCED, AND THAT PETITIONERS DID NOT COMPLY WITH SECTION 19055, IS AN INDEPENDENT AND CONSTITUTIONALLY ADEQUATE STATE GROUND; PETITIONERS LACK A JURISDICTIONAL BASIS FOR SUPREME COURT REVIEW.

A. The California holding at issue rests entirely upon an interpretation of California law.

Petitioners seek review of a California Court of Appeal holding which is based solely on California law and which constitutes an independent and adequate state ground. Lack of jurisdiction is clear in this case from the absence of any valid federal question in the petition.

Petitioners are essentially arguing that although an administrative tax refund procedure for pursuing a class claim remedy was available to them under Section 19055, and in spite of their own unexplained failure to even attempt to comply with the class claim filing requirements of this section, they should obtain tax refunds on behalf of countless unknown investor/taxpayers of the mutual funds in order to allegedly redress the federal fisc under the Supremacy Clause and 31 U.S.C. § 3124(a). This argument is purely result-oriented and challenges a holding which contains no federal element.

Prior to the amendment of Section 19055 in 1986, the California Personal Income Tax Law did not permit the filing of a class claim for tax refunds. (*Woosley*, *supra*,

3 Cal.4th at pp. 791-792.)[2/] The 1986 amendment to section 19055 expressly permitted, for the first time, the filing of a class claim but required that each member of the class authorize his or her inclusion in the class in writing and that each member of the class, or the class member's authorized representative, sign the claim for refund.

In 1986, similar amendments were made to section 26074 governing claims for refunds of bank and corporate taxes and in 1987, to section 6904 governing claims for refunds of sales and use taxes. The California Supreme Court noted that these amendments "were intended to spare the state the substantial administrative costs associated with identifying and notifying class members once a case had been certified as a class action." (*Woosley*, *supra*, 3 Cal.4th at p. 791.)

In fact it was the Board's expenditure of substantial administrative costs in administering the *Brown* class action (which, in light of *Woosley*, should not have been certified as a class action in the first place) which precipitated the written authorization amendments to Section 19055. (See Petition, A-2 and notes 3 and 8.) Far from petitioners' assertion that this was the second affirmative step taken by the Board to discourage refund claims (Petition, page

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2. The California Supreme Court specifically rejected the contention that prior to the enactment of amendments to sections 6904, 19055, and 26074, class claims were proper. (*Woosley*, *supra*, 3 Cal.4th 758, at pp. 791-792.) The *Woosley* Court stated: "The circumstance that, in amending sections 6904, 19055 and 26074, the Legislature chose to allow a narrowly circumscribed form of class claims, does not demonstrate that it previously had authorized a more expansive type of class claim." (*Woosley*, *supra*, 3 Cal.4th at p. 792.) Moreover, the Legislature's silence on the subject of class claims seeking refunds of taxes prior to the 1986 and 1987 amendments "did not constitute legislative authorization of such class claims." (*Ibid.*)

5), the Board-sponsored amendment of 19055 in fact created a class claim filing procedure where none had previously existed.

The Court of Appeal below stated: "The lesson of *Woosley* we take to be that statutes governing administrative tax refund procedures, backed as they are by a plenary constitutional authority, are to be strictly enforced." (Petition, A-10.) The California Supreme Court summarized these well established constitutional principles as follows:

> "The California Constitution expressly provides that actions for tax refunds must be brought in the manner prescribed by the Legislature. Article XIII, section 32, of the California Constitution provides in this regard: 'After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, *in such manner as may be provided by the Legislature.*' (Italics added.) This constitutional limitation rests on the premise that strict legislative control over the manner in which tax refunds may be sought is necessary so that governmental entities may engage in fiscal planning based on expected tax revenues. (See *State Bd. of Equalization v. Superior Court* (1985) 39 Cal.3d 633, 638 [217 Cal.Rptr. 238, 703 P.2d 1131].)" (*Woosley, supra*, 3 Cal.4th at page 789.)
>
> "In sum, article XIII, section 32, of the California Constitution precludes this court from expanding the methods for seeking tax refunds expressly provided by the Legislature." (*Woosley, supra*, 3 Cal.4th at p. 792.)

The present petition challenges California's requirement that, in order to maintain a class action lawsuit for income tax refunds, a would-be representative

of the class who files a class claim for refund must strictly comply with the mandatory class claim filing requirements of section 19055 and file such class claim in a timely manner. The application of California's class claim filing requirements to the facts of this case constitutes an independent and constitutionally adequate state ground. This case is not entitled to Supreme Court review.

B. Under this Court's *McKesson* decision, the federal Constitution permits the state procedural requirement which forms the basis of the California holding.

The administrative tax refund procedural requirements of Section 19055 are of the type of procedural protections expressly permitted by this Court in *McKesson*, *supra*, 496 U.S. 18, 44-45. In *McKesson*, this Court recognized the State's concern that its obligation to provide refunds for an unconstitutional tax may "undermine the State's ability to engage in sound fiscal planning" but found that such concern was sufficiently met by "[a] State's freedom to impose various procedural requirements on actions for postdeprivation relief." (*McKesson*, *supra*, 496 U.S. at p. 45.) The Court provided examples of permissible procedural requirements, noting, among others, that the state might "provide by statute that refunds will be available only to those taxpayers paying under protest or providing some other timely notice of complaint; execute any refunds on a reasonable installment basis; [and] enforce relatively short statutes of limitations applicable to such actions, ..." (Footnote omitted.) (*Id.* at p. 45.) Under the *McKesson* circumstances, this court found that Florida's "ability in the future to invoke such procedural protections suffices to secure the State's interests in stable fiscal planning when

weighed against its constitutional obligation to provide relief for an unlawful tax." (*Ibid.*)[3/]

The class claim filing requirements of Section 19055 clearly fit within *McKesson's* example of a permissible state requirement for "paying under protest or providing some other timely notice of complaint." (496 U.S. at p. 45.)

C. The decision below does not conflict with this Court's decision in *Harper*.

Petitioners contend that *Harper v. Virginia Dep't of Taxation*, 509 U.S. __, 113 S. Ct. 2510, 125 L.Ed 2d 74 (1993) stands for the proposition that "the remedy for unconstitutional state taxation is governed fundamentally by *federal* law" and that "[a] full refund is the *only* remedy that is sufficient under federal law where a State has imposed a tax like California's that federal law placed 'beyond [its] power to impose.' [quoting *McKesson*, 496 U.S. at 39.]" (Italics in the original, Petition, page 8.) Petitioners thus argue that "*Harper's* holding that the dictates of the Supremacy Clause may not be evaded on the basis of state fiscal interests (113 S. Ct. at 2519) perforce bars the application of a fiscal-based state law like Section 19055 when its purpose and effect is to deny complete market relief to the United States." (Petition, p. 16.)

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3. Petitioners attempt to give significance here to this Court's use of the phrase, "in the future", in *McKesson*. This Court was simply pointing out that apparently no procedural safeguard applied in the *McKesson* case itself, but that Florida could take such steps "in the future." In the present case, California's procedural safeguards in section 19055 were clearly in full effect at the time petitioners filed their claim for refund. There is no need to consider what California might do in the future; at the time of these claims, California had already acted in a way which is fully permissible under *McKesson*.

Petitioners have never challenged the validity of Section 19055 or its application to taxpayers other than the mutual funds' investor/taxpayers. Petitioners do not challenge the authority of the California Legislature to enact the class claim filing requirements contained in this section. In fact, contrary to petitioners' allegations, the purpose of the amendments to Section 19055 was not to "deny market relief to the United States" but to provide an administrative mechanism to identify potential class members and obtain their specific authorization regarding inclusion in the class.

The State's entire tax scheme is premised upon self-assessment, and in the case of claims for refund, self-identification by claimants and specification of all grounds for the claim for refund by the claimant. The Board was not, and is not, administratively equipped nor fiscally prepared to administer class relief where the identity of the claimants is unknown and the Board must solicit claims for refund against itself.

Moreover, tax refund cases present a unique situation in that each taxpayer who becomes a member of a class action thereby agrees to put the question of his tax liability for the entire tax year or years, at issue. By joining a class action, each taxpayer thereby subjects himself to a desk audit of his tax return(s) for the year(s) at issue. Written authorization from the taxpayer seeking to join the class action ensures that the taxpayer willingly was submitting himself or herself to the potential burdens as well as the potential benefits of such status.

In addition, the enactment of class claim filing requirements of Section 19055 does not have the effect of denying "complete market relief to the United States." This Court has stated that "[i]f a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he

can challenge the tax's legality, the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful back-ward looking relief to rectify any unconstitutional deprivation." (*McKesson*, *supra*, 496 U.S. at p. 31.) The Board clearly contemplated tax refunds as a remedy for any unlawful tax collection in this case as opposed to some other "corrective action by the State" which would be permissible where the State is found to have imposed an impermissibly discriminatory tax. (See *McKesson*, *supra*, 496 U.S. at pp. 40-41.)

The State's requirement of the filing of an administrative claim for refund as a prerequisite to a lawsuit for a tax refund predates this action by over 40 years.[4/] Thus, the California claim filing requirement clearly is not a "new state-law obstacle with the express purpose of frustrating the market relief that federal law requires." (Petition, p. 21.) All of the investor/taxpayers whom petitioners seek to represent had the opportunity to file timely individual claims for refund. The timely individual claims for refund filed by other investor/taxpayers are being handled administratively by the Board and refunds are being issued.

Petitioners erroneously assert that prior to the time that the tax at issue herein was collected, an administrative claim for refund was permitted to be filed by a single claimant on behalf of an absent class and that the Board and the California Legislature "changed this rule" to "restrict a *federal* tax remedy." (Italics in the original, see Petition, p. 21 and note 27.) Petitioners cite to *City of San Jose v. Superior Court* 12 Cal.3d 447 (1974), *Schoderbek v. Carlson* 113 Cal.App.3d 1029 (1980), *Lattin v. Franchise Tax Bd.* 75 Cal.App.3d 377 (1977), and *Santa*

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4. The original Section 19055 (see note 2, *infra*) was added in 1943 (stats. 1943, c. 659, §1.)

Barbara Optical Co. v. State Bd. of Equalization 47 Cal.App.3d 244 (1975). (Petition, note 27.)

The California Supreme Court specifically has held that prior to the 1986 amendments to Revenue and Taxation Code sections 6904 and 19055, and the 1987 amendments to Section 26074, class claims seeking tax refunds were not statutorily authorized and therefore impermissible under Article XIII, section 32 of the California Constitution. (*Woosley*, *supra*, 3 Cal.4th at p. 792.) The *Woosley* court specifically disapproved of the aforementioned decisions to the extent that they held to the contrary.

Having themselves filed a timely individual claim for refund, petitioners themselves are not precluded from obtaining a refund.[5/] Had they complied with the class claim filing requirements of Section 19055, petitioners could have pursued refunds on behalf of the class of the mutual funds' investor/taxpayers that they now seek to represent. Any fault for "failure to make the market whole by awarding refunds to substantially all aggrieved investors" (Petition, page 16) does not belong to the Board or the State of California but must be attributed to the petitioners who failed to follow California's procedural requirements on actions for postdeprivation relief which are of the type expressly found permissible by this Court in *McKesson*.

---

5. The Board has informed petitioners of its willingness to grant the claims for refund of petitioners Donald and Joan Farrar, as individuals, but not as representatives of any class for refund of taxes paid on distributions from two of the plaintiff mutual funds. (See Petition, A-3, note 4.)

D. *Felder* has no application to this tax refund case.

Petitioners do not claim that section 19055 is invalid as to all taxpayers. They argue that it is only invalid as to the taxpayers who had invested in the types of mutual funds involved in *Brown*.

In the hopes of evading the application of section 19055 with respect to this single class of taxpayers (i.e. the mutual funds' investors who did not file a timely claim for refund and were not properly included in any class claim for refund), petitioners argue that this Court's reasoning in *Felder v. Casey*, 487 U.S. 131 (1988), fits this case well and is "particularly instructive." (Petition, p. 18.) *Felder* is inapposite and has no application to this tax refund case.

In *Felder*, this Court held that under the principles of federalism and the Supremacy Clause, 42 U.S.C. § 1983 preempted the application of Wisconsin's notice-of-claim statute to a § 1983 action brought in state court. This Court's decision was based upon a finding that "the notice-of-claim statute at issue herein conflicts in both its purpose and effects with the remedial objectives of § 1983, and . . . its enforcement in such actions will frequently and predictably produce different outcomes in § 1983 litigation based solely on whether the claim is asserted in state or federal court . . . ." (*Felder*, *supra*, 487 U.S. at p. 138.)

This Court held:

> "Wisconsin's notice-of-claim statute undermines [§ 1983's] 'uniquely federal remedy,' *Mitchum v. Foster*, 407 US, at 239, 32 L Ed 2d 705, 92 S Ct 2151, in several interrelated ways. First, it conditions the right of recovery that Congress has authorized, and does so for a reason manifestly inconsistent with the

> purposes of the federal statute: to minimize governmental liability. Nor is this condition a neutral and uniformly applicable rule of procedure; rather, it is a substantive burden imposed only upon those who seek redress for injuries resulting from the use or misuse of governmental authority. Second, the notice provision discriminates against the federal right. While the State affords the victim of an intentional tort two years to recognize the compensable nature of his or her injury, the civil rights victim is given only four months to appreciate that he or she has been deprived of a federal constitutional or statutory right. Finally, the notice provision operates, in part, as an exhaustion requirement, in that it forces claimants to seek satisfaction in the first instance from the governmental defendant. We think it plain that Congress never intended that those injured by governmental wrongdoers could be required, as a condition of recovery, to submit their claims to the government responsible for their injuries." (*Felder, supra*, 487 U.S. at pp. 141-142.)

In contrast, a lawsuit to recover a tax refund does not involve a "uniquely federal remedy" and the requirement of the exhaustion of administrative remedies is well established in both state and federal tax law. In fact, the "doctrine of exhaustion of administrative remedies 'has received particular emphasis in tax enforcement cases.' (*People v. West Publishing Co.* 35 Cal.2d 80, 88 (1950) [citation omitted]." (*Barnes v.State Bd. of Equalization* 118 Cal.App.3d 994, 1001 (1981).)

California case law has made clear that the judicially developed rule of exhaustion of administrative remedies is distinguishable from the exhaustion prerequisite in tax refund actions which is constitutionally compelled. In

Patane v. Kiddoo 167 Cal.App.3d 1207, 1214 (1985), the Court of Appeal stated:

> 'The doctrine of exhaustion of administrative remedies was evolved by the courts to promote comity between coequal branches of government and to relieve overburdened courts from the need to deal with cases where effective administrative remedies are available. [Citation omitted.] **The judicially developed rule and, perforce, its exceptions, have no application to an action to recover a tax paid. Although exhaustion of administrative remedies is prerequisite to such an action, it is compelled not by the judicially created doctrine of comity and convenience, but by the constitutional grant of power to the Legislature to prescribe the manner of proceeding in such cases.** . . . We are not at liberty to alter the constitutionally authorized process by engrafting onto it exceptions borrowed from the judicially fashioned doctrine of exhaustion of administrative remedies. The authority to make such changes is confided in the Legislature by article XIII, section 32, of the Constitution, a provision which, we have recently been reminded by our high court, 'means what it says.' *Pacific Gas & Electric Co. v. State Bd. of Equalization* (1980) 27 Cal.3d 277, 284 [165 Cal.Rptr. 122, 611 P.2d 463].)" (Emphasis added.)

Similarly, it is well established under federal law that a taxpayer is required to file a claim for refund as a jurisdictional prerequisite to a suit for refund of taxes. (26 U.S.C. § 7422(a) and 26 C.F.R. 301.6402-2(b)(1); *United States v. Felt & Tarrant Co.*, 283 U.S. 269, 272, 51 S.CT. 376, 75 L.Ed.2d 1025 (1931); *Martinez v. United States*, 595 F.2d 1147, 1148 (9th Cir. 1979); *Omnibus Financial Corp. v. United States*, 566 F.2d 1097, 1101 (9th Cir. 1977.) Under federal case law, federal taxpayers must file

individual claims for refund, not class claims for refund, before they are entitled to bring a tax refund lawsuit. (See *Heisler v. United States*, 463 F.2d 375 (9th Cir. 1972, *cert. denied*, 410 U.S. 927 (1973); *Sutherland v. Egger*, 605 F.Supp. 28, 30 (W.D. Pa. 1984).

Thus, in contrast to the Wisconsin notice-of-claim provisions in *Felder*, the class claim filing requirements of Section 19055 constitute "a neutral and uniformly applicable rule of procedure", the purpose and validity of which must be recognized in light of similar administrative prerequisites to suit provided for under federal tax law.

In summary, the federal Constitution does not mandate that the States must provide for litigation of tax refund actions as class actions. The class claim filing requirements of Section 19055 are reasonable and strictly procedural in nature. The application of these procedural requirements in this case constitute an independent and adequate state ground that is not reviewable in this Court.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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26 U.S.C. § 7422(a) A1

California Revenue and Taxation Code § 6904 . . . A2

California Revenue and Taxation Code § 26074 . . A2

APPENDIX "B"

Public Service Bulletin No. 85-2 . . . . . B1

26 C.F.R.
§ 301.6402-2. Claims for credit or refund.

* * *

(b). Grounds set forth in claim.
(1) No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. The statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit.

* * *

26 U.S.C.
§ 7422. Civil actions for refund.

(a) No suit prior to filing claim for refund. No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim

for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof. * * *

Revenue & Taxation Code
§ 6904. Claim: writing; statement of grounds

(a) Every claim shall be in writing and shall state the specific grounds upon which the claim is founded.

(b) A claim filed for or on behalf of a class of taxpayers shall do all of the following:

(1) Be accompanied by written authorization from each taxpayer sought to be included in the class.

(2) Be signed by each taxpayer's authorized representative.

(3) State the specific grounds on which the claim is founded.

Rev. & Tax. Code
§ 26074. Claim for refund; writing; grounds; class claims

Every claim for refund shall be in writing, shall be signed by the taxpayer or the taxpayer's authorized representative, and state the specific grounds upon which it is founded. A claim filed for or on behalf of a class of taxpayers shall do all of the following:

(a) Be accompanied by written authorization from each taxpayer sought to be included in the class.

(b) Be signed by each taxpayer or taxpayer's authorized representative.

(c) State the specific grounds on which the claim is founded.

February 7, 1985

PUBLIC SERVICE BULLETIN NO. 85-2

READ IMMEDIATELY

Benham Corp/Capital Preservation Class Action Suit

Purpose of Bulletin

To provide information on the Benham Corporation class action suit (*Brown, et al.*, v. *FTB*; SP #803759) and define public service procedures for handling contacts relating to this matter.

Background

The Franchise Tax Board is involved in a class action suit which challenges the taxability of distributions (dividends or benefits) received from several funds administered by the Benham Corporation. The suit contends that since the three funds (Capital Preservation Fund, Capital Preservation Fund II, and Capital Preservation Note Trust) derived their income exclusively from United States Treasury debt securities, the distribution of the income should not have been taxed.

*In March 1984, the superior Court decided the issue in favor of the class of taxpayer/investors for the TYS 1978 - 1981.

*The Superior Court has ordered FTB to issue notification and tax refund claim forms to the class of taxpayer/investors for the TYS 1979-1981. The purpose of the notice is to

- inform the investors of the class action suit and the amount of refund they may be entitled to receive.

- provide a claim form on which they may elect to be included in the plaintiff class and, if appropriate, challenge the refund calculated by FTB.

*The case is not yet closed, and a considerable period of time could elapse before all appeals are exhausted.

What FTB Is Doing

The "Tax Refund Claim Form" and Notice of Plaintiff Class Action Determination" (see copies attached) are being sent to all identified investors.

* Approximately 11,000 notices were mailed on February 6, 1985 with a taxpayer response by April 1, 1985.

* An estimated 80,000 additional notices will be mailed April 30, 1985 with a taxpayer response date of July 1, 1985.

Responsibilities The Document Resolution Section is responsible for reviewing the returns and completing the information on the claim form. That unit will also handle the returned claim forms and any correspondence, amending returns or other information pertaining to this court case.

Important!! NOTE Because the taxpayer's legal rights as members of the plaintiff class could be involved, public service personnel should not attempt to explain the notices or claim forms or to advise the taxpayer about what to do, except as authorized below under "What to tell the taxpayer."

What to Tell the Taxpayer All communications are to be in writing. The procedures which follow are to assure that inquiries are handled uniformly and information gets to the correct unit.

(Plaintiff's Exhibit No. 5, Joint Appendix In Lieu of Clerk's Transcript (on Appeal), pages 397-398)

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DEC 10 1993
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No. 93-788

In The

Supreme Court of the United States

October Term 1993

Donald E. Farrar, et al.,
Petitioners,

vs.

Franchise Tax Board,
Respondent.

On Petition For Writ of *Certiorari*
to the California Court of Appeal, First District

Brief *Amicus Curiae* on behalf of
Howard Jarvis Taxpayers Association and
Association of California Car Clubs
in support of Petitioner

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Brief *Amicus Curiae* on behalf of Howard Jarvis Taxpayers Association and Association of California Car Clubs in support of Petitioner

---

Having received the written consent of all parties to file this brief, Howard Jarvis Taxpayers Association and Association of California Car Clubs respectfully submit this brief *amicus curiae* in support of the petitioner for writ of *certiorari*, pursuant to Rule 37 of this Court. Consents have been filed with the Clerk. Neither association has a parent or reportable subsidiary under Rule 29.1.

INTERESTS OF AMICI CURIAE

Howard Jarvis Taxpayers Association is a non-profit public interest organization comprised of 240,000 members, some of which are believed to be members of the aggrieved class herein. The issue herein is also central to other cases in which the association is fighting unreasonable procedural barriers to challenging unconstitutional taxes. The Jarvis Association grew out of the passage of California's Proposition 13; its namesake, Howard Jarvis, was a father of the Jarvis-Gann Tax Limitation Initiative popularly know as "Proposition 13." The Jarvis Association and its co-*amicus* are uniquely qualified to alert the Court to the

danger which the opinion below poses to federal sovereignty far beyond the facts of this case.

California Association of Car Clubs is an organization promoting the preservation of historic vehicles; some of the Car Club's members are believed to be members of the class herein and others are targets of California's illegal tax discrimination against out-of-state collector vehicles. The Car Club is *amicus curiae* in the case upon which the California Court of Appeal principally relied in this case, *Woosley v. California*.[1] *Woosley* is on remand to the trial court. If *Woosley* is left unchanged, it will deprive many of Car Club's members of refunds of discriminatory license taxes on a theory very similar to the theory which the court below utilized in this case. All three levels of California courts unanimously found that the vehicle license fee at issue in *Woosley* discriminates against interstate commerce, but California's Department of Motor Vehicles continues to demand the discriminatory taxes (under threat of criminal sanctions) from a significant portion of the Car Club's members more than a year after the California Supreme Court's affirmation of the ruling that the discrimination violates the Commerce Clause.[2]

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[1] *Woosley v. State of California*, 3 Cal. 4th 758, 838 P. 2d 758, 13 Cal. Rptr. 2d 30 (1992) ("*Woosley*"). In *Woosley* the California Supreme Court *sua sponte* overturned a unanimous line of California cases endorsing class notices-of-claims for refund of taxes and held they were forbidden except where, and to the extent, specifically authorized by California tax statutes. The court remanded *Woosley* on two minor issues, but despite the remand Mr. Woosley petitioned this Court for a writ of *certiorari*. The State of California objected, *inter alia*, that the petition was premature (No. 92-1605, Brief of Respondents State of California et al., in Opposition to Petition for Writ of *Certiorari*, pp. 6-7, n. 3) and this Court denied *certiorari* (113 S.Ct. 2416 (1993)).

[2] The Legislature amended the vehicle license fee statute to eliminate the discrimination for vehicles purchased by their current owners after

REASONS FOR GRANTING REVIEW

I. THE OPINION BELOW PROVIDES A ROAD MAP FOR ANY STATE TO IGNORE THE FEDERAL CONSTITUTION ANY TIME IT PLEASES, AND THE OPINION CREATES A CONFLICT

As demonstrated *infra*, unduly burdensome state procedural barriers to the refund of taxes imposed on an activity encouraged by federal law influence human actions and market forces just as effectively as direct state prohibitions. Here, California utilized this truism to discourage investment in federal securities and thereby transgressed on the balanced federalism and respective spheres of sovereignty envisioned by the Constitution. The California Franchise Board ("Board") taxed interest on federal securities and after a court determination that such taxes were illegal, blocked any practical redress of the damage it caused to the market place for said securities. At the Board's request the California Legislature enacted a requirement that notices-of-claim for refunds on behalf of classes must be accompanied by the written consent of each class member at the time the notice is filed (the "Written Consent" requirement). This procedural legislation was applied retroactively to taxes previously collected illegally which are the subject of the instant action. Further bolstering the implementation of the State's *ex post facto* procedural barriers, years after initiation of this action California courts started to treat strict satisfaction of claim statutes as non-waivable jurisdictional requirements (*Woosley*, *supra*, 3 Cal. 4th at 789, 792), overruling a long line of controlling precedent, contrary to *stare decisis*. In California the Written Consent requirement "divides and conquers" people following fed-

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July 31, 1990; however, the Department of Motor Vehicles continues to discriminate in respect of vehicles purchased before that date.

eral encouragement by effectively denying them any practical weapon in their fight to protect their federal rights.

Effectively, California's message to those wishing to respond favorably to federal incentives to purchase federal obligations is:

> "The federal government may promise you that their bonds will be free from California taxes; however, we will make it so prohibitively expensive to exercise this right (by erecting limitless procedural barriers to a refund of such taxes) that you will wish that you had ignored the federal encouragement. And, for good measure, we do not have to tell you what the barriers will be in advance."

Such a threat is highly effective molder of conduct against federal objectives when the individual has a viable choice and relatively little money at stake, such as in instant case. Undoubtedly some people avoided investing in federal obligations because of the California tax risk. This reduced the market demand for the obligations. Under the facts of this case an investor could have (1) invested hassle-free in tax-free California obligations or (2) invested in federal obligations and borne the burden of satisfying all of the unknown roadblocks which the State might erect in the investor's way to evade making the refund -- the refund which is necessary to achieve the federal tax-free market place objective. Obviously, given these alternatives the rational investor will forgo investing in federal obligations. To contend that this burden against federal obligations does not have a forbidden negative influence on market decisions is analogous to arguing that a cloud on real property's title does not affect its marketability.

In this case the purchase of federal obligations is the federally-encouraged activity, but (if not barred by this Court) California's needless obstacles to refund will provide the pretext to effectively discourage all federally-protected activities, both activities specifically encouraged by

the United States and activities against which states are forbidden to discriminate, i. e. against interstate commerce.[3] One of the reasons why this Court reached its pre-emption holding in *Perez v. Campbell*, 402 U. S. 637 (1971) was because of the potential harm from giving a road map for states to avoid federal will.

> "[S]uch a doctrine would enable state legislatures to nullify nearly all unwanted federal legislation by simply publishing a legislative committee report articulating some state interest or policy -- other than frustration of the federal objective -- that would be tangentially furthered by the proposed state law." *Id.* at 652.

The California Court's opinion recognizes no restriction on California's erection of procedural barriers. In one short paragraph (Petition's App. at A-10 - 11) the court simply said that the taxpayer class had not cleared the barrier and that *McKesson Corp. v. Florida Alcohol & Tobacco Division*, 496 U. S. 18 (1990) ("*McKesson*"), allows barriers. The court refused to consider possible pre-emption of the procedural barrier. (App. at A-10.) In essence, it adopted the Board's insupportable attitude that the Board need not make a refund required by federal law unless the California Legislature says so. However, the right to a refund arises from federal law and cannot be unreasonably restricted by states. Extending the court's logic to other federally protected areas vividly demonstrates the infirmity of its decision.

If one were to assume, for example, that a State were imposing a tax clearly targeting a particular religion, undoubtedly this Court would hold that the State could not erect burdensome procedural barriers to excuse retaining the illegal tax. Strict scrutiny Equal Protection precedent

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[3]For ease of reading we do not always repeat the observation that what is said about federal encouragement also applies to federal prohibitions against state discrimination.

would become a mirage if States were able to prohibit through the tax procedure or "jurisdictional" back door what the state unquestionably cannot accomplish through the prohibition front door. The procedural back door is unnecessary procedural barriers to the return of unconstitutional taxes on the protected activity. It would cripple federal objectives to allow them to be evaded so easily. The reasoning which this Court would undoubtedly use in striking down unnecessary procedural barriers to redress religiously discriminatory taxation is equally applicable here. Compare, *Garrett v. Bamford*, 538 F. 2d 63 (3rd Cir. 1976) (allowing a tax case to proceed in federal court despite the Tax Injunction Act because the state opposed class actions and the case involved an important federal constitutional right).

This Court has held that strict local rules of procedure cannot be used to impose unnecessary burdens on rights of recovery authorized by federal laws (*Brown v. Western R. of Alabama*, 338 U. S. 294, 298-299 (1949) and underscored the public policy considerations favoring class actions in *Phillips Petroleum Co. v. Shutts*, 472 U. S. 797 (1985). *Phillips* demonstrates this Court's concern for the plight of the individual with a "small claim," or a lack of familiarity with the law. *Id.* at 809. Here it is against these expressed policies of federal law to allow the State needlessly to burden individual taxpayers; it is not practical to fight California's mass production taxation of federal rights with the Written Consents millstone around taxpayers' necks. Against this oppressive procedural barrier, the individual taxpayer with a modest claim is poorly armed to fight a constitutional battle against systemic, mass scale illegal taxation.

This court has a long history of pre-empting rules of procedure which interfere with federal policies. *American Ry. Exp. Co. v. Levee*, 263 U. S. 19 (1923) (local burden-

of-proof rule pre-empted by federally-sanctioned limitation-of-liability); *Davis v. Wechsler*, 263 U. S. 22, 24-25 (1923) (state rule re waiver of defenses pre-empted); *Brown v. Western R. of Alabama*, 338 U. S. 294, 299 (1949) (over-exacting local pleading requirements could not cause dismissal of federally created rights); *Dice v. Akron, C. & Y. R. Co.*, 342 U. S. 359, 361-363 (1951) (in a jury trial on a federal right, judge could not decide whether liability release was obtained by fraud); *Monessen Southwest R. Co. v. Morgan*, 486 U. S. 330, 335-336 (1988) (availability of prejudgment interest on federal law claim determined by federal law rather than local procedure).

Even closer to the controlling issue of instant case, many of this Court's decisions have struck down or waived administrative review barriers to the enforcement of important federal rights. In addition to cases cited in Petition, see *Mathews v. Diaz*, 426 U. S. 67, 75-77 (1976) (government waived requirement that plaintiff wait for an administrative decision); *Gibson v. Berryhill*, 411 U. S. 564, 574 (1973) (excused failure of corporate optician to litigate propriety of corporate practice of optometry before a board comprised of non-corporate opticians); *McNeese v. Board of Education*, 373 U. S. 668, 674-675 (1963) (administrative exhaustion not required in school segregation dispute).

Of special interest here is *Montana Bank v. Yellowstone County*, 276 U. S. 499, 505 (1927) (exhaustion deemed re state tax where agency had no power to correct). Here, the Board is also powerless to correct the federal violation because it cannot rule that a state statute violates the U. S. Constitution. Cal. Constitution art. III, § 3.5. Thus, under the Board's theory an important federal objective can be defeated by requiring Written Consents for a class notice-of-claim to a body which has no power to grant relief. The notice-of-claim was an exercise in futility, but Mr. Farrar

tried. The only purpose of the Written Consent requirement is to dissuade claims for refund.

Most of this Court's recent dissenting opinions in cases finding pre-emption have also recognized the principle that states cannot be allowed in the name of procedure to defeat important substantive rights granted by Congress, but simply disagree on where to draw the line. See, *Felder v. Casey*, 487 U. S. 131, 157 (1988) (O'CONNOR, J. dissenting) ("*Felder*"); *Southland Corp. v. Keating*, 465 U. S. 1, 31 (1984) (O'CONNOR, J. dissenting).

> "It is settled that a state court must honor federally created rights and that it may not unreasonably undermine them by invoking contrary local procedure. The assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice. *Brown v. Western R. of Alabama*, 338 U. S. 294, 299 (1949)." *Id.* (Internal quotes omitted.)

Now is the time for this Court to spotlight the limits on the lengths to which the states may go before the states dig themselves into an even deeper hole by relying more and more on unconstitutional taxes in their budgeting process, relying on the opinion below as a King's X to protect them from having to pay the money back. The states, as well as the country as a whole, will be much more healthy if the states rely on legitimate sources of revenue. Otherwise, some day states will be taught a very expensive lesson when they misjudge the practical ability of a burdensome procedural barrier to protect them from their folly. It would be much less painful for the lesson to be learned early before the amounts of money involved become a major problem.

California's Written Consent requirement also conflicts with the enforcement of federal policy in other states. The Written Consent barrier stands in stark contrast with the situation in several states in which tax authorities are encouraged to follow federal policy and do not impose unconstitutional taxes because taxpayers can easily use class

notices-of-claims to uphold federal policy. In Arizona and Colorado, for instance, in practice as well as theory, the tax authorities are forced to exempt interest on federal obligations because aggrieved classes can use class procedures to force the refund of taxes when the tax authorities do not comport to federal law. *Andrew S. Arena, Inc. v. Superior Court*, 163 Ariz. 423, 788 P. 2d 1174, 1176 (Ariz. 1990); *Kuhn v. Colorado, Department of Revenue*, 817 P. 2d 101, (Colo. 1991). Such lack of conformity in enforcement of federal rights is contrary to the teachings of *Brown*, *supra*, 338 U. S at 295.

A conflict is also created because other states properly recognize that no notice-of-claim is required where the sole issue is constitutionality. *State, Dept. of Taxation v. Scotsman Mfg.*, 849 P. 2d 317, 319 (Nev. 1993). This Court should resolve these conflicts.

II. CALIFORNIA'S BARRIERS AGAINST GROUP ENFORCEMENT OF FEDERAL POLICY ARE PRE-EMPTED BECAUSE THEY DEFEAT AN IMPORTANT FEDERAL OBJECTIVE AND SERVE NO VALID STATE OBJECTIVE

A. The Validity Of State Procedural Barriers Should Be Determined By Weighing Legitimate Benefits To The State Against The Detriment To Federal Policy

In assessing a state law's impact on the federal objective, this Court looks as at the law's effects and refuses to rely solely on the legislature's stated purpose. *Glade v. National Solid Wastes Management Assn*, __ U. S. __, 112 S. Ct. 2374, 2387, 120 L. Ed. 2d 73 (1992), citing *Perez v. Campbell*, 402 U. S. 637, 651-652 (1971). Where the purpose or predominant effect of a state procedural device is to deny meaningful redress of important federal rights

(and Congress has not spoken on the device[4]) *Amici* submit that the Supremacy Clause requires a heightened scrutiny analysis. Since few rules have been laid down in this area, we suggest requiring the State to justify the barrier in a manner analogous to the justification required for discrimination against suspect classes and interstate commerce. As detailed below, the Board has not even begun to make such a showing and the court below refused to do any weighing.

This Court compares (1) the burden on a federal policy, and the significance of the policy, to (2) the valid policy behind the state procedural device. See Note, State Enforcement of Federally Created Rights, 73 Harvard L. Rev. 1551, 1560-1561 (1960). We ask the Court to consider the following criteria which appear appropriate for determining whether state practices unconstitutionally impinge on federal sovereignty: the importance of the federal objective, the burden on the party seeking to protect federal rights, the ability of the procedure to affect encouraged behavior, whether the procedure facilitates the determination of the dispute, whether the procedure is discriminatory against federal interests, the clarity of the procedure at the time the federally encouraged activity took place, and good faith.

A heightened scrutiny analysis of these factors exposes the Board's Written Consent requirement as an unconstitutional interference with federal policy, requiring it to be pre-empted. Any legitimate Board objectives could be achieved by much less burdensome measures than Written Consents.

As fully detailed in the Petition at 9-11 and in section I above, the Written Consent requirement places an unnecessary and insurmountable barrier in the way of the party

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[4]Of course, if Congress has specified, or prohibited a procedure, no weighting is allowed on the point.

standing up for an important federal policy here and tends to discourage the primary behavior encouraged by federal policy. In the latter respect, this case is more favorable for pre-emption than *Brown v. Western Ry., supra*, 338 U. S. 294, because it affects federally encouraged behavior -- investing in federal bonds. In contrast, it is unlikely that Georgia's pleading rules affected the care which the railroad showed for working conditions.

The Written Consent requirement was never meant to serve any substantial purpose to aid in the determination of a dispute, but rather merely as a trap for the unwary and as an insurmountable legal obstacle to all but the most persistent and wealthy. Board's calling the barrier an administrative remedy does not make it so. There is no record of a California administrative body ever approving a class notice-of-claim for refund of taxes, much less how the Written Consent requirement aided or smoothed the process. Examples of procedural rules which generally serve compelling dispute-determination purposes are: filing deadlines, page limitations for briefs, presumptions placing the burden of going forward, etc. Most importantly, these procedural devices are facially neutral and apply equally to all parties. Their purpose is to make the dispute resolution process run more smoothly (not to avoid it). Here, in contrast, the dispute resolution is not advanced one iota by the State's procedural requirement; rather, the requirement serves only to arbitrarily strengthen the State's goal of retaining its ill-gotten gains and thwarts the fair resolution of federal issues on their merits.

The Written Consent requirement was not apparent or foreshadowed, much less "strictly or regularly followed" at the time the unconstitutional *taxes were paid*. A state procedural rule has to be strictly and regularly followed to have any weight in adjudicating federal issues (*Hathorn v. Lovorn*, 457 U. S. 255, 263 (1982)) and timely *(McKesson,*

supra, 496 U. S. at 24, n. 4). Board's arguments to the contrary, there was no strictly enforced prohibition of class claims at the time the taxes were paid. As detailed in the Petition at 21, an unbroken line of cases endorsed class claims for refund until October 1992 when the California Supreme Court *sua sponte* reversed the line in *Woosley, supra*, 3 Cal. 4th 758, thereby foisting upon innocent class members, who had misplaced their trust in *stare decisis*, a deprivation of rights and property because the statute of limitation had run.

The Written Consent requirement is discriminatory against federal rights. The requirement is not neutral, first, because the Board has no power to rule the California statute unconstitutional. Cal. Constitution, art. III, § 3.5. See *California Comm'n v. United States*, 355 U. S. 534, 539 (1958) (Administrative procedures pre-empted because statute was clearly aimed at the United States and Commission was unqualified to decide constitutional issues).

Second, the requirement is not neutral because it "... extends only to governmental defendants and thus conditions the right to bring suit against the very ... entities Congress intended ..." (*Felder, supra*, 487 U. S. at 144) to forbid from taxing interest on federal obligations. "[T]he notice-of-claim provision most emphatically does discriminate in a manner detrimental to the federal right: only those persons who wish to sue governmental defendants are required to provide notice ..." (*Id.* at 146.)

> "[T]he notice-of-claim provision is imposed only upon a specific class of plaintiffs -- those who sue governmental defendants -- and, as we have seen, is firmly rooted in policies very much related to, and to a large extent directly contrary to, the substantive cause of action provided those plaintiffs. This defendant-specific focus of the notice requirement serves to distinguish it, rather starkly, from rules uniformly applicable to all suits, such

> as rules uniformly applicable to all suits, such as rules governing service of process or substitution of parties...." *Id* at 145.

Finally, there is discrimination against enforcing the prohibition against taxation of federal interest because (1) class notices-of-claims are allowed for non-tax disputes with California government entities (*City of San Jose v. Superior Court*, 12 Cal. 3d 447, 454-458, 525 P. 2d 701, 115 Cal. Rptr. 797 (1974)) and (2) the administrative body is required to give notice of format deficiencies in non-tax notices-of-claims to avoid waiver (California Govt. Code § 911).

The facts here are even stronger for pre-emption than in *Felder* and answer the reservations of the *Felder* dissent. First, unlike in *Felder*, the Board is forbidden by the California Constitution to give the relief necessary -- the ability to declare a statute unconstitutional. Cal. Constitution, art. III, § 3.5. Second, the barrier in *Felder* apparently was in place when the federal right arose, but it was not imposed here until after the right arose. Third, it would have been relatively easy for Mr. Felder to have filed suit in federal court to avoid the state barrier, and it would have been very difficult here. 28 U. S. C. § 1341. Fourth, Mr. Felder filed no notice-of-claim, but Mr. Farrar did. Finally, compliance in *Felder* would not have been expensive (*Felder*. at 149) but it would be here. This case is much closer to *Brown v. Western R. of Alabama*, 338 U. S. 294, 298-299 (1949) than to *Felder*, and the *Felder* dissent took pains to distinguish *Felder* from *Brown*. 487 U. S. at 159-160 (O'CONNOR, J., dissenting).

California cannot credibly claim that it exercised good faith. In 1983 the trial court in *Brown v. Franchise Tax Board*, 197 Cal. App. 3d 300, 242 Cal. Rptr. 810 (1987) relied on cases applying settled precedent in finding the tax illegal, yet the Legislature did not repeal, and the Board continued to collect, the tax for many years. There is no

evidence that the Board timely attempted to persuade the Legislature to correct the flawed legislation. Instead it sought to build a procedural moat around the illegal tax. Unfortunately, California has not manifested any good faith desire to comport to Constitutional dictates, and it is this Court's duty to force California to remedy its wrong.

B. The Result, And The Only Credible Purpose, Of California's Written Consent Requirement Is To Discourage Federal Objectives

The purpose of California's restrictions on class notices-of-claims was, and is, to make it essentially impossible for victims of indiscriminate collection of federally-prohibited taxes to redress California's evasion of the federal policy. California's statutory requirements were specifically enacted in response to the predecessor of this action, *Brown v. Franchise Tax Board* (*supra*, 197 Cal. App. 3d 300) (holding illegal the very taxation at issue here and certifying a class)) to make *impossible* the class action approach that was so successful in that action. (Petition's App. at A-17 - 18.)

The principal valid purpose of claim statutes -- to give the agency notice -- is better served by encouraging class claims for refund than by discouraging them. The valid purpose of notice-of-claim statutes is to give public entities an opportunity to investigate, correct and settle the problem promptly without the cost of litigation. *Tucker v. Alexander*, 275 U. S. 228, 231 (1927); *Felder, supra*, 487 U. S. at 157 (O'CONNOR, J. dissenting). Individual claims are less likely to alert the Board to the scope of a systemic problem than a class claim. The Board has to decipher and piece together individual claims to estimate the eventual scope of the problem and resulting exposure. On the other hand, a class notice gives an overall description of the problem, highlighting the common issues of fact an law and describing the group of people harmed. See section C

below. It is also more likely to grab the agency's attention than an individual claim, and provide a precise legal basis for the Board to consider.

C. The Board's Rationalizations For The Written Consent Requirement Are Illogical And Do Not Withstand Heightened Scrutiny

A proper pre-emption analysis of any alleged justification for a state procedural barrier must assume that everyone affected will vault the procedural hurdle. Discouraging the refund of illegally collected taxes is an invalid objective. The Board's rationalizations rest on the advantages to the Board of taxpayers failing to clear the barrier. In contrast, Statutes of limitations are justified by the benefits to the system from *compliance* with the rule -- actions being filed within a reasonable period of time -- not by the benefit to the opponent when a litigant *fails to comply* with the statute.

None of the Board's arguments for requiring the Written Consents at the time of notice-of-claim filing is credible. The pretexts given were to avoid the

> "administrative effort and expense ... in order to [1] identify the class members, [2] notify and [3] correspond with the class members, [4] evaluate their claims, and [5] ultimately issue refunds." (Petition's App. at A-17 - A-18, numbering added.)

None of these purposes is a credible reason for placing a crippling burden on the class representative at the time the notice-of-claim is filed. California has a well thought out, efficient body of law on class actions which the Board and the Written Consent requirement ignore. See generally 4 Witkin, California Procedure, Pleading (3rd Ed. 1985), §§ 193, *et seq.* San Francisco Superior Court Class Action Rules 427.1-.7 ("Rules" of the trial court in this action) provide a useful framework for analyzing the validity of the

Board's reasons. An excerpt from the Rules is reproduced in our Appendix at pages 1a-7a.

We now address the Board's ostensible reasons:

1. Requiring Written Consents from the class members when the notice-of-claim is filed does nothing to reduce the Board's cost of determining each class member's name at the time the name is needed. Rule 427.1(g) recognizes that it is most efficient to identify the class members late in the process. (However, an examination of the difficulty of identifying individual class members is an important early sub-issue under Rule 427.3, and existence of the class member's names on computerized records (such as here) is a big plus.) The Board has given no justification for determining the names prior to decision on the central issue, i.e. the Board's procedure puts the cart before the horse. Moreover, once names are required, the costs of identification could be paid out of the common fund, according to the equities of the case, because allocation of identification costs is within the sound discretion of the court. See Rule 427.6, Appendix at 6a. Furthermore, the Legislature could require that the costs be paid out of the common fund despite the equities, a much less intrusive burden on federal objectives than the Written Consent.

2. Requiring Written Consents from the class members does not reduce the Board's cost of giving notice to class members. Rule 427.6 recommends that consideration of notice be delayed until after all other class certification issues are decided. It recognizes that notice is not always be required and that notice by publication may be more appropriate than notice by mail. (Rule 427.6, our Appendix at 6a, (b)(ii).) Even though the normal (and justifiable) result is that when the Board loses it pays the cost of notice, the Legislature could have taken the much less intrusive step of requiring that notice be paid out of the common fund rather than effectively prohibiting class claims.

3. Requiring Written Consents of class members at the notice-of-claim stage tends to increase rather than decrease the Board's cost of corresponding with class members. The very fact that they have been contacted to obtain their consent logically will cause them to ask more questions of the Board than if they had not been prematurely contacted.

4. Written Consent to a class notice-of-claim does nothing to simplify the evaluation burden other than by the illegal expedient of discouraging meritorious claims. Evaluation consists of two parts: (1) evaluation of common issue of law and fact (Rule 427.2), and (2) evaluation of each individual's facts. On the common issues law and facts, class claims are more efficient for the Board to evaluate than individual claims because they are more likely to be prepared by experts and are more likely to avoid specious or legally untenable arguments than individual claims. In this case, the principle individual fact to be evaluated is how much federal interest was taxed to each individual. In some cases the Board will have all of the information it needs in its computerized records and a proof of claim to obtain individual amounts would be wasteful. Payors of interest (such as the mutual funds) are required to report to the tax authorities in computer readable form the amount of interest paid to each person with the person's social security number. 26 U. S. C. § 6049. Thus, evaluation of the amount for each person is possible without additional information from the class member. If information were required from class members to determine each member's individual amount, class members could fill out questionnaires customized for the case rather than having to speculate years in advance as to what information the Board needs. The important point in analyzing the Board's evaluation argument is that any constitutional analysis of this argument must assume that every person aggrieved by the Board's action gives consent, but the Board's argument re-

lies on the fact that few class representatives have the resources to secure consents. In short, the State is imposing antiquated methods of gathering information pertaining to tax refund claims for the disingenuous purpose of making assertion of taxpayers' rights needlessly burdensome. The disingenuousness of the State's methodology is thoroughly exposed by its ingenuousness in information gathering when it is collecting taxes; i.e. it demands and receives information on computer disks. It could and should use the same information to make refunds here.

5. Contrary to the Board's argument, the cost of issuing refund checks is a normal cost of a government which would not be reduced by Written Consents. If the Board approved 40,000 separate claims, it would have to prepare its internal paperwork for and issue 40,000 checks. If the Board's denial of 40,000 claims were overturned in court it would still have to issue and mail 40,000 checks. Requiring 40,000 Written Consents prior to filing a class claim does nothing to change this fact.

The Board's real complaint was that it had to justify costs outside of its normal budget for sending out 40,000 checks in *Brown*; however, this Court's reversing here would help that problem, too. Once this Court gives the Legislature the message that burdensome procedural barriers will not protect states from having to return taxes collected in violation of federal policy, the Legislature can no longer so easily ignore the probability of the Board having to make refunds of illegally collected taxes in establishing budgets. The Legislature will also be more likely to avoid passing obviously illegal taxes in the future. In contrast, taxpayer *compliance* with the Written Consent requirement does nothing to alleviate the Board's budget problem, only *failure to comply* alleviates the problem.

6. Finally, consent of the taxpayer is implicit (or it could be explicitly obtained) by the class member's endorsement of the refund check.

D. The California Court Of Appeal Read A Few Sentences Of *McKesson* Out Of Context As A Pretext To Evade Federal Policy

Many courts are undermining federal policy by taking a few words out of context from the opinion in *McKesson Corp. v. Florida Alcohol & Tobacco Division*, 496 U. S. 18 (1990) ("*McKesson*") as an unlimited justification for procedural barriers.

Both the context and the wording of *McKesson's* discussion of procedural devices demonstrate that this Court's endorsement of procedural devices was limited to those giving tax authorities a fair opportunity to estimate their legal exposure for financial planning, not to give them an unfair advantage in keeping unconstitutional taxes. The Florida Supreme Court ruled that, due to Florida's need for fiscal planning, the surprise occasioned by the court's finding of a Commerce Clause violation justified Florida's failure to redress the constitutional wrongs. *Id.* at 44. This Court overruled, and answered the Florida court's "surprise" argument by observing that states can protect their interest in "stable fiscal planning" with various procedural devices. *Id.* at 45. The emphasis of this Court in *McKesson* was on the financial *stability*, not the financial *condition*, of Florida. "Stability" focuses on predictability for planning, avoiding unforcastable ups and downs, giving governments time to plan and develop alternate sources of funds. States need a fair opportunity to manage their affairs in an orderly fashion, but nothing in *McKesson* approves what California has done here -- impose unjustified *ex post facto* procedural barriers for the purpose of enriching the State. Taxpayers should not be able to sandbag states with refund exposures and legal theories out of the blue, but states should not be

able to sandbag taxpayers with non-waivable procedural requirements, and that is what the Board did here.

Furthermore, *McKesson* is explicit in holding that the procedural devices must be in place when the taxes are paid (*Id.* at 24, n. 4) but the requirement of Written Consents was not passed until 1986, after the payments at issue.

While some examples of procedural devises were mentioned in *McKesson*, no specific device was before the Court and there was no discussion of pre-emption of procedural barriers which unduly interfere with federal policies. The court below took this Court's concern for avoiding surprise as a *carte blanche* for states to erect unlimited retroactive procedural barriers to evade altogether the financial consequences of their violations of federal policies. This interpretation is at fundamental odds with the bedrock holding of *McKesson* that States cannot use their own financial *condition* as an excuse for not eliminating discrimination against interstate commerce. *Id.* at 50.

CONCLUSION

We urge this Court to grant *certiorari* because the states know that united, the taxpayers can stand up to the states' illegal actions, but divided the taxpayers fall victim to action-influencing unconstitutional taxation. In this and many other cases the tax is contrary to the national policy and will discourage conduct encouraged by federal policy.

Respectfully submitted,

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Appendix

Excerpt from San Francisco Local Rules of Court

Class Actions

427. ISSUES: DOCUMENTS FOR PRESENTATION

Set out in Section 427.1-.7 are the issues which must be resolved by order after one or more hearings. Also set out with each issue are subjects which should be included in the documents submitted in support of each party's position on said issue. These subjects are not exclusive but do represent the minimum information which the court deems necessary for presentation by the parties on each issue.

.1. *Issue: Constitution of the class.* The party alleging existence of a class will submit one or more declarations which present facts describing in detail the composition of the class, including the following: (The facts submitted in a declaration must stand the test to which oral testimony would be subjected in the trial of an action. The declaration should contain enough competent evidence to convince the trier of fact. Averments which are satisfactory in pleadings are not competent evidence. The declaration should show the source of the declarant's information, that is, the declaration should contain a proper foundation.)

(a) The approximate number of persons in the class. If there are subclasses, the declaration also should describe each and set out the approximate number of persons in each subclass.

(b) The general geographical location (or locations) of the class members. If the class is not confined to California, the description will include those locations outside California where the class members are located.

(c) A description of the status of the class members where relevant to the action (e.g., minors, particular ethnic, occupational, economic, professional or other group).

(d) A description of the members of each subclass between whom issues of law or fact must be litigated.

(e) A description of those class members, including an estimate of their number, whose claims must be approved or evidence presented only as to each individual member.

(f) Other facts which describe the class. These other facts should describe the class with sufficient thoroughness that it therefore can be accurately and particularly described.

Further, the class representative will submit a statement presenting his position concerning:

(g) The manner in which and the time when the individual class members will be identified. If individual identification is not contemplated, the reasons therefor (e.g., reliance on fluid class recovery or nonmonetary relief. See *Blue Chip Stamps v. Superior Court* (1976) 18 Cal. 3d 381.)

(h) Other matters relevant to this issue:

If the declarations demonstrate that the class is interstate, the party maintaining the action will submit, in addition to other memoranda, a memorandum on the subject of whether this court has jurisdiction to render a binding judgment in favor of, or against, nonresident, unserved class members.

.2. *Issue: Common, Similar and Unique Questions of Law and Fact.* Each party will submit a statement discussing each of the following:

(a) Those issues of law which are common to all class members.

(b) Those issues of law which are similar to all class members and, with respect to each such issue, a detailed

statement concerning how said issues may be determined on other than an individual basis.

(c) Those issues of law which are unique to one or more class members, but which must be presented in the trial. In the description of these unique issues of law, the segments of the class to which they are applicable will be described with a statement of the number within the class to whom each unique issue applies.

(d) The issues of law which must be litigated between class members.

(e) Those issues of fact which are common to all class members.

(f) Those issues of fact which are similar to all class members, with a detailed statement concerning how each such issue can be determined other than on an individual basis.

(g) Those issues of fact which are unique to one or more class members but which must be presented in the trial. In the description of these unique issues of fact, the segments of the class to which they are applicable will be described with a statement of the number within the class to whom each unique issue applies.

(h) The issues of fact which must be litigated between class members.

Each party also will discuss whether the issues of law and fact which are either common to all members of the class or, if not common, are similar and susceptible to proof by evidence applicable to all members of the class, predominate over issues which must be tried on an individual basis. These statements will set out an estimate of the number of witnesses and the time for their testimony upon issues which exist only as to individual or subclasses

(including issues which must be litigated between class members).

.3. *Issue: Superiority of the Class Action to Other Available Methods for the Fair and Efficient Adjudication of the Controversy.*

Each party will submit statements concerning:

(a) Procedures alternative to a class action which might adjudicate the issues involved in the action. These will include an estimate of the time of trial of each alternative proceeding.

(b) The effectiveness of the remedies available under the alternatives described compared to those available under the class action. This could include a discussion of the number of persons who may receive compensation after each alternative proceeding (whether directly or indirectly by virtue of the judgment) and the difference, if any, in the amount thereof.

(c) The ability of the court to manage the alternative proceedings in relation to its ability to manage the conduct of the class action.

(d) The benefit to the public from each alternative proceeding. (E.g., if the action challenges the constitutionality of a statute, is a class action therefor of any greater benefit to the public than one on behalf of named plaintiffs only?)

(e) The propriety of relief other than money damages. This should include a discussion of the alternatives of fluid recovery, injunctive relief without any type of money damages (except attorney's fees and costs), or a combination of several types of relief.

(f) A description of other actions purporting to be brought on behalf of the same class, raising the same or similar issues, and a statement of the reasons the instant action should be allowed to proceed parallel to the others or

should be abated or dismissed. (See section 427.7(a) for motions to coordinate cases pursuant to Code Civil Procedure, sec. 404 et seq.)

(g) If the action purports to be brought on behalf of a class which includes residents of states other than California, a statement as to whether (aside from jurisdictional limitations) the court should limit the class to California residents for reason of public policy and manageability.

* * *

.6. *Issue: Necessity for and Content Of Notice.*

It is recommended that this issue not be dealt with until the party advocating the existence of the class has received a favorable ruling from the court on the first five issues. At the time of the court's favorable ruling on the first five issues, the court will generally shorten the time for notice of this sixth issue.

When the moving party submits a motion concerning this issue, such motion must include:

(a) Original and copy of proposed order approving notice to the class;

(b) Original and copy of proposed notice to the class of pendency of class action.

Although as a general rule notice to the class of the pendency of the action shall be ordered, notice to the class is not necessary in all actions, and an order may be made, on motion of a party, dispensing with the requirement that the class be notified of the action. When a public entity or a public officer or public employee in his official capacity is an unnamed member of the plaintiff or defendant class, notice of the motion to dispense with the requirement that the class be notified of the action must be served on said public entity, public office or employee in the same manner as a civil summons is served.

When the moving party submits a motion for an order concerning the giving of or dispensing with notice, such party will submit a statement on each of the following (e.g., said party will submit the proposed orders set forth above, even though he seeks an order dispensing with notice):

(a) A document discussing whether notice should be given at all.

(b) A statement which assumes that notice will be given and discusses:

(i) The time when notice should be given.

(ii) The manner in which notice will be given. This will include a discussion concerning whether said notice should be published, mailed or otherwise brought to the attention of class members. If recommended to be published, it will include the recommended publication media, including an estimate of the cost thereof. If recommended to be mailed, it will include a statement of the manner in which addresses of the class members will be obtained and an estimate of the cost of preparation of the notice and of said mailing. If notice is to be given through other means, a description of said other means will be set out in detail, including an estimate of the cost. Each estimate of cost will contain a statement of the factual basis thereof. Each statement also will include an estimate, with the factual basis therefor, of the percentage of the class members which the party believes will receive knowledge of the pending action through use of each notice media.

(iii) The party which should bear the cost of giving the notice or manner in which the cost thereof should be divided between the parties.

(c) Each proposed notice will include, at least, a representation concerning each of the following:

(i) Brief explanation of the case, including basic contentions or denials of the parties.

(ii) Any member who so requests by a specified date may exclude himself from the class and the action by giving notice thereof ("opting out").

(iii) Information concerning how class members who desire to be excluded from the class ("opt out") may give notice thereof.

(iv) The claim of a member who does not request to be excluded from the class will be terminated by the judgment in the action under the rule of res judicata.

(v) Any member who does not request exclusion may move the court for permission to appear as a named class corepresentative.

(vi) The estimated total amount of the recovery, the anticipated fee which will be sought by counsel for the class, the anticipated other expenses and costs to the class which will be paid from the funds recovered before distribution of the net proceeds to class members, and the net amount to be recovered by each member if the action is successful (a formula statement will be satisfactory).

(footnotes omitted.)

(4)

No. 93-788

Supreme Court, U.S
FILED
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OFFICE OF THE CLERK

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1993

DONALD E. FARRAR, et al.,
Petitioners,

VS.

FRANCHISE TAX BOARD,
Respondent.

On Petition For Writ Of Certiorari to the California Court of Appeal, First District

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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On Petition For Writ Of Certiorari to the California Court of Appeal, First District

REPLY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The force of the case for certiorari is not diminished by the arguments of Respondent Franchise Tax Board ("the Board"). Rather, the need for this Court's review has only grown more apparent since the Petition was filed: the Pennsylvania Supreme Court, following *Felder v. Casey*, 487 U.S. 131 (1988), has now held state procedural barriers preempted as applied to a class action for the refund of an unconstitutional tax. *Murtagh v. County of Berks*, No. 34 M.D. Appeal Doc. 1992, 1993 Pa. LEXIS 283 (Pa., Nov. 10, 1993) (reproduced in Reply App. at R-5).[1] The conflict among the state courts on *Felder* preemption of procedural conditions on the refund of unconstitutional state taxes makes action in this Court more urgent than before.

[1]Petitioners first learned of the *Murtagh* decision well after the November 12 filing of the Petition.

The case for certiorari was already strong enough before *Murtagh*. The Petition asks this Court to decide whether California offended the Supremacy Clause when it imposed a procedural condition that protected its own fisc by failing to redress the injury that California's unlawful tax inflicted on the market for United States obligations. Not even the Board contests the importance of this question. Indeed, it does not deny (1) that California's unlawful tax depressed the market for federal obligations; (2) that California is obliged to redress that market injury; (3) that a market-wide tax refund is the only remedy that is sufficient to redress that market injury,[2] and is the remedy that federal law requires; and (4) that California may not evade this federal remedy on the basis of its own contrary fiscal interests.

Instead, with scarcely a reference to the United States Constitution or its Supremacy Clause, the Board offers essentially two rejoinders. First, it attempts to take issue with petitioners' statement of the undisputed facts; and then it purports to discover an independent and adequate state-law ground in the decision below. Neither rejoinder succeeds, and neither justifies denying certiorari. For the reasons given in the Petition, and to resolve the conflict between the decision below and *Murtagh*, this Court should grant certiorari on the question of whether Section 19055's "arid ritual of meaningless form" (*Staub v. City of Baxley*, 355 U.S. 313, 320 (1958)) is preempted.

A. Amended Section 19055 Is Preempted Because Its Purpose And Effect Are Inconsistent With The Federal Refund Remedy.

The record is clear that California amended Section 19055 for the *purpose* of protecting its fisc at the expense of paramount federal fiscal interests (*see* Pet. at 9), and that amended Section 19055 had precisely the intended *effect*. Where a State imposes a notice-of-claim and exhaustion requirement that "conflicts in both its purpose and effects with [federal] remedial

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[2]Ironically, the Board assigns blame for the absence of an adequate market remedy not to California's prohibitive procedural hurdle, but to the investors who, predictably, found it insurmountable. Resp. Br. 14.

objectives," that requirement is preempted. *Felder*, 487 U.S. at 138. *See* Pet. at 18-19. The Board argues that *Felder* preemption does not extend to tax cases. Resp. Br. at 15.[3] But it ignores this Court's emphatic ruling in *Harper v. Virginia Department of Taxation*, ___ U.S. ___, 113 S. Ct. 2510 (1993), that the fiscal interests of the offending State may not serve as a ground for denying tax refunds that federal law prescribes. Pet. at 14-15.

Since *Harper* was decided, the Pennsylvania Supreme Court has expressly repudiated the Board's premise by applying *Felder* preemption to a tax-refund case.[4] *Murtagh*, a Section 1983 class action brought to challenge Pennsylvania's discriminatory "Welcome Stranger" real property tax assessment policy on equal-protection grounds (App. R-5, R-6), presented the question whether plaintiffs' failure to exhaust state remedies was a sufficient ground for dismissing that class action. App. R-7.[5] The Pennsylvania Supreme Court held that it was not, and relied on *Felder*'s refusal to allow "procedure[s] that place[] conditions on the vindication of a federal right in state court." App. R-12, R-14.[6] The court found the case for preemption, in one respect, even stronger than that in *Felder*, for state *tax* remedies typically

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[3]Citations are to the Board's revised brief, which contains the correct docket number.

[4]Before *Harper*, the state courts had refused to do so. *E.g. Boughton Trucking Materials, Inc. v. County of Will*, 229 Ill. App. 3d 576, 579, 593 N.E.2d 1119, 1121 (Ill. App. 1992). *See also* cases cited in Pet. at 19 n.25.

[5]The class representatives had exhausted their administrative, but not judicial, remedies under state law; the unnamed class members, of course, had exhausted no state-law remedy. App. at R-5, R-15. The court left open the question whether an individual plaintiff, as opposed to a class, would be similarly excused from exhausting state remedies. App. at R-16 n.16.

[6]Finding an "apparent conflict" between *Felder* and *Fair Assessment in Real Estate Association v. McNary*, 454 U.S. 100 (1981), and noting the lack of "direction from the United States Supreme Court on this issue," the *Murtagh* court concluded that *Felder* governed the preemption question. App. at R-9, R-14. The state courts that had faced this

result in "additional expense and delay . . . without according the taxpayers the relief sought." App. R-14, R-15.

Petitioners, while they do not proceed under Section 1983, pray for the "uniquely federal remedy" (*Felder*, 487 U.S. at 141) that arises under the tax immunity statute, 31 U.S.C. Section 3124(a).[7] California's notice-of-claim requirement "undermines" that federal remedy (487 U.S. at 141; *see* Pet. at 10-13); it is therefore preempted, unless, as the Board claims (Resp. Br. at 15), *Felder* preemption does not extend to tax cases. *Murtagh*'s conclusion that *Felder does* govern tax cases is in clear conflict with the decision below.

The Board attempts to justify the decision below on the ground that exhaustion requirements are particularly important in tax-refund cases. Resp. Br. at 16.[8] But it is unable to explain the need to prohibit a class representative from exhausting administrative remedies on behalf of a class, as was done both in *Brown v. Franchise Tax Board*, 197 Cal. App. 3d 300, 242 Cal. Rptr. 810 (1987) (*see* Pet. at 3-6), and in *Murtagh*. App. R-5. The *Murtagh* court specifically rejected the argument that the pre-

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conflict before *Harper* (*see* note 4, *supra*) had treated *Fair Assessment* as controlling. *See* Pet. at 19 & n.25.

[7]The Board is unpersuasive in contending that the remedy sought here is somehow less "uniquely federal" than that in *Felder*. *See* Resp. Br. at 16. Having collected a tax which was altogether "beyond [its] power to impose," federal remedial principles leave California "no choice" but to " 'undo' the unlawful deprivation by refunding the tax." *McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 39 (1990). A full refund is the only remedy consistent with 31 U.S.C. § 3124(a) and with the Federal Government's interest in protecting its financial markets from depredations by the States. *See* Pet. at 10.

[8]The Board's reliance on *federal* tax law (Resp. Br. at 17-18) is misplaced, as the command of the Supremacy Clause does not reach federal law. In any event, the Board cites no authority that holds that an individual may not file a claim for a federal tax refund on behalf of a class, and ignores at least one case in which a court entertained a class action relating to the disposition of federal tax refunds despite the failure to file *any* claim. *Nelson v. Regan*, 731 F.2d 105, 109 (2d Cir.), *cert. denied*, 469 U.S. 853 (1984).

emption of state remedies would "disrupt state and local tax administration," observing that class-action constitutional challenges "probably will, in the long run, significantly reduce the inconvenience, inefficiency, delay and expense involved in countless individual lawsuits over the same issue . . . ." App. R-15, R-16.

The Board, finally, attempts to escape the application of *Felder* and *Harper* by claiming that petitioners "misstate[d] the record in asserting that the Board actively deterred taxpayers from filing individual claims for refund." Resp. Br. at 5. It pegs its claim of misstatement primarily on the contention that the portion of its internal bulletin quoted in the Petition[9] "referred to the recommended response that Board employees should give to taxpayers inquiring about their claims for refunds already pending before the Board," and *not* to "potential claims for refund which had not yet been filed"—claims, that is, for tax year 1982 and later. Resp. Br. at 5. The bulletin itself, however, decisively refutes this contention. The quoted language falls under the general heading "What to Tell the Taxpayer," and follows immediately after the legend "Questions pertaining to *tax year 1982 or subsequent.*" App. R-3 (emphasis added).

No more correct is the Board's claim that the Petition misstated the record in regard to the legislative history of amended Section 19055. The record, says the Board, discloses no intent to "thwart class relief for tax refunds" (Resp. Br. at 6), nor any purpose of denying market relief to the United States. Resp. Br. at 12. Notably, the Board does not dispute that the *effect* of the

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[9]"Tell the Taxpayer 'the issue you raise is currently before the Superior Court in the class action suit *Brown et al. v. Franchise Tax Board.* Action on claims for refund raising this issue is being deferred until the case is decided and all appeals are exhausted. A considerable period of time could elapse before this occurs, and your patience in this matter is appreciated.' "

Pet. at 4. App. at R-3. This portion of the bulletin is not reproduced in the Board's incomplete appendix. Resp. Br., App. B. Petitioners have reproduced its entire text in the appendix below.

amendment was to accomplish both results; and the *purpose* of the amended statute is no more in dispute than its effect.

The amended statute's purpose was to reduce the administrative cost of the refund remedy federal law requires. This the Board admits: it says it propounded the amendment in response to its "expenditure of substantial administrative costs in administering the *Brown* class action" (Resp. Br. at 8);[10] and it continues to plead that it is not "fiscally prepared to administer class relief." Resp. Br. at 12.[11] If this were not enough, the Board takes the position that everyone who requests a refund is subject to "the potential burdens" of an audit of his or her tax returns. Resp. Br. at 12. By singling out for an audit those taxpayers who seek the refund of an unconstitutional tax on federal obligations, the State further demonstrates its intent to burden the federal refund remedy. There is no question but that Section 19055 was amended for the purpose of vindicating the fiscal interests of the State, and that the State accomplished this by means inconsistent with paramount federal fiscal interests. *See* Pet. at 9. Under

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[10]Contrary to the Board's assertion, the Court of Appeal made no factual finding that the Board "incurred . . . more than $1 million" in administering the *Brown* class action. *See* Resp. Br. at 6. Nor does the Board's brief say how much of that purported $1 million expense was attributable to administrative steps that it is not required to take whenever it issues a refund. See Pet. at 17 & n.23. In fact, the record below contains no evidence that the administrative cost to the State per dollar of refund is likely to be any less when every member of a class of taxpayers complies with Section 19055 than when none do.

[11]The Board now adds that the purpose of the amendment was to provide an "administrative mechanism" to identify potential class members. Resp. Br. at 12. The amended statute, however, neither provides a procedure by which the agency will identify class members (e.g., out of its computer data base) nor addresses the allocation of the cost of identifying class members (e.g., out of the common fund). Instead, the purported "administrative mechanism" is to throw the entire administrative burden of identifying the members of a class on to an individual taxpayer as a precondition of even filing a class claim. Of course, the need to identify class members at the administrative level does not even arise until liability is conceded.

Felder and *Harper*, application of Section 19055's requirements to this action is preempted.

B. No Independent, Adequate State Ground Insulates From This Court's Review The Refusal Of The Court Below To Find Section 19055 Preempted.

The remainder of the Board's effort is devoted to challenging this Court's jurisdiction. It argues, in effect, that the lower court's ruling that petitioners failed to comply with the preempted state statute is an independent and adequate state ground of decision. The Board misapprehends the doctrine on which it relies. If a state court decision "upholds a particular state action on the ground that it offends neither federal nor state law, then the Supreme Court has power to review the state court judgment" on the federal question. Justice O'Connor, *Our Judicial Federalism*, 35 CASE W. RES. L. REV. 1, 5-6 (1984). That is what happened here. The court below held that (1) petitioners had not complied with Section 19055, and (2) federal law did not preempt the application of Section 19055 to this action. While its first holding is not subject to review in this Court, the second, federal ground surely is.

Put differently, a state ground is not adequate unless the state court could render the same judgment after reversal by this Court on the federal ground. Here, class certification was denied solely for noncompliance with Section 19055. If Section 19055's prohibitive requirements are preempted by federal law, as petitioners contend, that state ground cannot support the state court's conclusion. *See, e.g., Staub,* 355 U.S. at 319 (failure to secure unconstitutional license not an adequate state ground). In short, it is "always a federal question whether federal law has . . . superseded state law . . . ." 16 C. Wright, A. Miller, E. Cooper & E. Gressman, FEDERAL PRACTICE & PROCEDURE: JURISDICTION Section 4021 at 676 (1977).

Indeed, petitioners' failure to comply with Section 19055's "arid ritual of meaningless form" (*Staub*, 355 U.S. at 320) is not even a *tenable* state ground. This Court has held untenable those state grounds that are conveniently manufactured for the occasion:

> " 'Novelty in [state] procedural requirements cannot be permitted to thwart review in this Court applied for by those who, in justified reliance upon prior decisions, seek vindication in state courts of their federal constitutional rights.' " (*Ford v. Georgia*, 498 U.S. 411, 423 (1991) (quoting *NAACP v. Alabama*, 357 U.S. 449, 457-58 (1958)))[12]

Here, the Board admits it proposed the amendment to Section 19055 in direct response to a lawsuit that forced it to pay refunds of the very tax here at issue.

The Board relies on *Woosley v. California*, 3 Cal. 4th 758, 838 P.2d 758, 13 Cal. Rptr. 2d 30 (1992), *cert. denied*, — U.S. —, 113 S. Ct. 2416 (1993), for the proposition that California provided no class-refund remedy until Section 19055 was amended. As demonstrated in the Petition, however, California courts had recognized such a remedy since well before the collection of the tax here at issue. Pet. at 21 n.27.[13] *Woosley* merely overruled previously-settled law; by no means did it, nor could it, erase the historical fact that, at the time the tax here at issue was collected, and the refunds applied for, an unbroken

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[12]*See also Barr v. City of Columbia*, 378 U.S. 146, 149 (1964) (rejecting state procedural requirements which are not strictly or regularly followed"); *Davis v. Wechsler*, 263 U.S. 22, 24 (1923) ("the assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice"); *Ward v. Love County*, 253 U.S. 17, 22 (1920). The state court in *Ward* had refused to refund a tax levied on tribal property. Challenging this Court's jurisdiction, the respondent contended that the judgment rested on independent and adequate state grounds, namely, the state court's conclusion that no statute authorized the refunds. This Court reversed, stating that "non-Federal grounds of decision that were without any fair or substantial support" did not divest it of its authority to vindicate the federal right to the refund of the unlawful tax. 253 U.S. at 22.

[13]At no time during the course of the *Brown* litigation did the State object that California law did not permit a class-claim for tax refund. Indeed, the State "consider[ed] the question [of the availability of class claims] to be settled" until the *Woosley* court, *sua sponte*, raised the issue in 1992. 3 Cal. 4th at 788.

series of appellate decisions in California upheld an unrestricted class remedy for the refund of unlawful taxes.[14]

CONCLUSION

For the reasons expressed in this Reply and in the Petition, we respectfully urge the Court to grant certiorari. This Court's action is especially urgent in light of the conflict of the decision below with the Pennsylvania Supreme Court's recent decision in *Murtagh*.

DATED: December 22, 1993

Respectfully,

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[14]As noted in the Petition, the "novelty" of the challenged procedure also runs afoul of this Court's specific command that only a tax-refund procedure which "was in effect at the time of the tax payments" may bar a refund claim. *McKesson*, 496 U.S. at 24 n.4. *See* Pet. at 20-21. The Board ignores that command. Resp. Br. at 11 n.3. Nor does *McKesson* offer the Board comfort in any other respect (*cf.* Resp. Br. at 10-11), for that case neither raised nor addressed the requirements of the Supremacy Clause where an unlawful state tax injures the Federal Government's capital market.

February 7, 1985

PUBLIC SERVICE BULLETIN NO. 85-2

READ IMMEDIATELY

BENHAM CORP/CAPITAL PRESERVATION CLASS ACTION SUIT

PURPOSE OF BULLETIN

To provide information on the Benham Corporation class action suit (Brown, et. al., v. FTB; SP#803759) and define public service procedures for handling contacts relating to this matter.

BACKGROUND

The Franchise Tax Board is involved in a class action suit which challenges the taxability of distributions (dividends or benefits) received from several funds administered by the Benham Corporation. The suit contends that since the three funds (Capital Preservation Fund, Capital Preservation Fund II, and Capital Preservation Note Trust) derived their income exclusively from United Status Treasury debt securities, the distribution of the income should not have been taxed.

- In March 1984, the Superior Court decided the issue in favor of the class of taxpayer/investors for the TYS 1978-1981.
- The Superior Court has ordered FTB to issue notification and tax refund claim forms to the class of taxpayer/investors for the TYS 1979-1981. The purpose of the notice is to
  - inform the investors of the class action suit and the amount of refund they may be entitled to receive.
  - provide a claim form on which they may elect to be included in the plaintiff class and, if appropriate, challenge the refund calculated by FTB.
- The case is not yet closed, and a considerable period of time could elapse before all appeals are exhausted.

WHAT FTB IS DOING	The "Tax Refund Claim Form" and Notice of Plaintiff Class Action Determination" (see copies attached) are being sent to all identified investors. • Approximately 11,000 notices were mailed on February 6, 1985 with a taxpayer response by April 1, 1985. • An estimated 80,000 additional notices will be mailed April 30, 1985 with a taxpayer response date of July 1, 1985.
RESPONSIBILITIES	The Document Resolution Section is responsible for reviewing the returns and completing the information on the claim form. That unit will also handle the returned claim forms and any correspondence, amending returns or other information pertaining to this court case.
IMPORTANT!! NOTE	Because the taxpayer's legal rights as members of the plaintiff class could not be involved, public service personnel should *not* attempt to explain the notices or claim forms or to advise the taxpayer about what to do, except as authorized below under "What to tell the taxpayer."
WHAT TO TELL THE TAXPAYER	All communications are to be in writing. The procedures which follow are to assure that inquiries are handled uniformly and information gets to the correct unit.

WHAT TO TELL TAXPAYER (continued)	If the taxpayer has . . .	Then . . .
	Received claim forms and notice, asks questions regarding tax years 1978-1981.	Instruct the taxpayer to write all questions and mail them to the address on the claim form, which is: Franchise Tax Board Attn: Document Resolution 53, Sacramento, CA 95840-0068.
	NOT received a claim form and notice and questions regarding tax years 1978-1981.	• Ask the taxpayer the following . . . - Taxpayers Account No. - Taxpayer's Full Name - Tax payer's Current Address - Year(s) in Question • and - District Office—refer the information to District Office Liaison Unit in the Information Center Section. - Central Office—refer the information to Document Resolution Section, Attn: Jackie Lewis.
	Questions pertaining to tax year 1982 or subsequent	Tell the Taxpayer "the issue you raise is currently before the Superior Court in the class action suit *Brown et. al., v. Franchise Tax Board.* Action on claims for refund raising this issue is being deferred until the case is decided and all appeals are exhausted. A considerable period of time could elapse before this occurs, and your patience in this matter is appreciated."

AMENDED RETURNS

Amended returns which mention the Capital Preservation Funds, or trust, the Benham Corporation and/or the court case [Brown et. al., v. FTB) as the basis of the adjustment will be processed by the Exceptions Unit, Document Resolution Section as follows:

Returns for tax years 1978, 1979, 1980 and 1981.	Route to Document Resolution Attn: Jackie Lewis after posting in the Withholding System. These will be processed when the case is resolved.
Returns for tax years 1982 and subsequent.	Issue ATS letter X125 (attached). ATS will route returns to Cher Woehl, administrative services bureau. These returns will be held until the issue is finally decided by the courts.

QUESTION

If you have any questions regarding this bulletin on the Benham Case, please contact Cher Woehl Administrative Services Bureau at 355-0431 or (ATSS 438-0431).

/s/
Director, Taxpayer Services Bureau

MERRY J. MURTAGH, SPENCER LEE CHERASHORE, FREDERICK MURTAGH et al.,
Appellants
v.
COUNTY OF BERKS, et al.,
Appellees
No. 34 M.D. Appeal Docket 1992

SUPREME COURT OF PENNSYLVANIA

March 8, 1993, ARGUED

November 10, 1993, DECIDED

MR. JUSTICE FLAHERTY

Merry J. Murtagh and other taxpayers appeal an order of Commonwealth Court reversing an order of the Court of Common Pleas of Berks County and remanding with instructions to dismiss the action for lack of subject matter jurisdiction. The trial court had concluded that it had subject matter jurisdiction over a class action brought by the taxpayers against the County of Berks and other local government units under 42 U.S.C. § 1983[1] challenging the constitutionality of the manner in which property is assessed for real estate tax purposes.

The taxpayers, representing a class of recent purchasers of real estate in Berks County, filed an amended complaint, after exhausting state administrative remedies, against the local governments.[2] They asserted that the local governments had adopted a

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[1]42 U.S.C. § 1983 (1988) creates a remedy for violations of federal rights committed by persons acting under color of state law. Section 1983 provides as follows:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State . . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

[2]The taxpayers originally sued the County of Berks, the Berks County Board for the Assessment and Revision of Taxes and the Berks County

discriminatory "Welcome Stranger" policy. This policy results in the reassessment of recently purchased realty based on the purchase price while making no modifications in the assessment of comparable property not recently sold.[3] The taxpayers alleged that this practice violated their equal protection rights under the Fourteenth Amendment and, because the reassessments were done under color of state law, constituted a violation of 42 U.S.C. 1983.[4]

The local government defendants filed preliminary objections to the amended complaint based on, among other things, a lack of

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Board of Assessment Appeals. The county and the board filed a number of preliminary objections to taxpayers' complaint. The trial court sustained only one of the objections finding that taxpayers had failed to sue the taxing authorities which were indispensable parties. As a result, taxpayers filed an amended complaint joining all taxing authorities in the county, nearly 100 cities, boroughs, townships and school districts, herein referred to as the local governments.

[3]The Constitution and statutes of the Commonwealth embody a system of taxation that requires property to be taxed at a uniform rate according to its estimated actual market value. *See* Pa. Const. art. VIII, § 1; 72 Pa.C.S. § 5020-101 et seq. and § 5342 et seq.

The Commonwealth Court recently invalidated a county tax assessment scheme where it found that the county violated the uniformity requirement of the state Constitution and equalization requirement of the statute governing assessments by third-class counties. See *City of Lancaster v. County of Lancaster*, 143 Pa. Cmwlth. 476, 599 A.2d 289 (1991).

[4]The substance of the taxpayers' complaint is that the "Welcome Stranger" policy of Berks County causes de facto discrimination and violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. Taxpayers cite, as authority for their claim, *Allegheny Pittsburgh Coal Co. v. Commissioner of Webster County*, 488 U.S. 336, 1095 S. Ct. 633, 102 L.Ed. 2d 688 (1989). There, the Supreme Court held that the de facto discrimination engendered by a "Welcome Stranger" policy in a "current value" taxation system violated said Equal Protection Clause. *See also Nordlinger v. Hahn*, U.S., 112 S. Ct. 2326, 120 L.Ed. 2d 1 (1992).

Given the procedural posture of this case, it is inappropriate to comment on the merits of the taxpayers' case.

subject matter jurisdiction. The trial court dismissed both sets of preliminary objections, and certified the issue for appeal pursuant to Pa.R.A.P. 1311(b). Commonwealth Court granted separate petitions for permission to appeal the order, consolidated the appeals, and reversed.

The question presented is whether state courts must entertain Section 1983 class actions challenging the constitutionality of a county's tax assessment procedure where plaintiffs have not exhausted state administrative and judicial remedies. The local governments contend that the trial court does not have subject matter jurisdiction over such a Section 1983 action, arguing that state courts should follow the direction of the federal courts and refrain from entertaining such suits where there are plain, adequate and complete state administrative and judicial remedies.[5]

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[5]The local governments further argue that some state courts have refrained from entertaining such suits. *See, e.g., Bach v. Chilivus*, 236 Ga. 500, 224 S.E. 2d 370 (1976). Since these cases pre-date important Supreme Court cases discussed infra, we do not find them probative of the issue presented.

Courts that do require their courts to hear Section 1983 actions before exhaustion of state statutory remedies include Mississippi and New Jersey. *Burrell v. Mississippi State Tax Commission*, 536 So. 2d 848 (Miss. 1988) and *Bung's Bar & Grille, Inc. v. Florence Township*, 206 N.J.Super. 432, 502 A.2d 1198 (1985). In *Burrell*, the court held that state courts must hear taxpayers' actions brought pursuant to Section 1983, because they have concurrent jurisdiction with the federal courts, because the Supremacy Clause of the United States Constitution requires that state courts enforce the valid enactments of Congress, of which Section 1983 is one, and because the principle of comity did not apply to state courts. In *Bung's Bar*, the Superior Court held that the state courts must entertain Section 1983 actions, since New Jersey law demands that all issues of a controversy be included at the same time in a lawsuit and the available administrative remedy did not allow for civil rights claims. Neither court addressed the exhaustion of remedies argument.

See also Nutbrown v. Munn, 311 Ore. 328, 811 P.2d 131 (1990); *Hogan v. Musolf*, 163 Wis. 2d 1, 471 N.W.2d 216 (Wisc. 1991), and *L.L. Bean Inc. v. Bracey*, 817 S.W.2d 292 (Tenn. 1991). In these cases, Section 1983 actions were entertained by state courts.

Federal courts have routinely refrained from interfering with the administration of state taxes due to the Tax Injunction Act, 28 U.S.C. Section 1341, and principles of comity. In *Fair Assessment In Real Estate v. McNary*, 454 U.S. 100, 102 S. Ct. 177, 70 L.Ed. 2d 271 (1981), the Supreme Court of the United States ruled that actions for injunctive relief and monetary damages from a state property assessment procedure are barred in the federal courts by the principle of comity. That court said that comity concerns motivated congress to pass the Tax Injunction Act which prohibits a district court from enjoining, suspending or restraining the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such state.[6] 454 U.S. at 103, 102 S. Ct. at 179, 70 L.Ed. 2d at 275. By enacting that statute, congress recognized that the autonomy and fiscal stability of states survive best when their tax systems are not subject to scrutiny in federal courts. 454 U.S. at 102-03, 102 S. Ct. at 179, 70 L.Ed. 2d at 275. The Supreme Court of the United States also ruled that a similar action for monetary damages is likewise barred as long as the state provides for plain, adequate and complete remedies, because such actions are just as intrusive to the states' revenue collection systems as the actions for injunctive relief specifically under the Tax Injunction Act 454 U.S. at 114-15, 102 S. Ct. at 185, 70 L.Ed. 2d at 282. The court then stated that such taxpayers are to seek protection of their federal rights by state remedies provided that those remedies are plain, adequate, and complete and may ultimately seek review of the state decisions in the Supreme Court of the United States. 454 U.S. at 116, 102 S. Ct. at 186, 70 L.Ed. 2d at 283.[7]

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[6]The Tax Injunction Act of 1937, 28 U.S.C. § 1341, provides that:

> The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such state.

[7]The Court discerned no significant difference between remedies which are "plain, adequate, and complete" as the phrase is used to articulate the doctrine of equitable constraint under comity and those that are "plain, speedy and efficient," within the meaning of the Tax

State courts are not bound by *Fair Assessment* and its progeny. The Tax Injunction Act applies by its very terms to preclude federal courts, not state courts, from enjoining state tax schemes. Therefore, there is no danger of federal court interference or misunderstanding. Likewise, abstention based on comity has no application when a Section 1983 cause of action is brought in state courts because there is no risk of federal court interference.[8]

The local governments nonetheless argue that the state courts should abstain from hearing Section 1983 claims until the taxpayers have exhausted state administrative and judicial remedies. They appear to argue that Section 1983 plaintiffs in state court should be no better off than Section 1983 plaintiffs in federal court. Therefore, they should be required to exhaust the administrative and judicial remedies set forth in the Third Class County Assessment Law (TCCAL)[9] and in the General County Assess-

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Injunction Act. *Fair Assessment*, 454 U.S. at 116 n.8, 102 S. Ct. at 186 n.8, 70 L.Ed. 2d at 283 n.8.

[8]On the other hand, the federal courts have followed Fair Assessment in cases similar to the Taxpayers' case. e.g., *Sunderland Properties, Inc. v. County of Berks*, 750 F. Supp. 704 (E.D. Pa. 1990). There, a challenge to the county's "Welcome Strangers" policy was dismissed by the court based upon comity and the Tax Injunction Act of 1937, 28 U.S.C. § 1341.

[9]Act of June 26, 1931, P.L. 1379, as amended, 72 P.S. §§ 5342-5350. This act does not have an official name but is commonly referred to as the Third Class County Assessment Law.

The Third Class County Assessment Law creates a three-member board of assessment appeals (board) in each county. Aggrieved taxpayers appeal to the board and then to the county common pleas court. The board must cause annual assessment of property within its jurisdiction. Section 1 and 3 of the TCCAL; 72 P.S. §§ 5342,5344. Property owners subject to these assessments must be duly notified. Section 8(b) of the TCCAL; 72 P.C § 5349(b). A property owner who is aggrieved by any assessment, whether or not the assessment has been changed from the previous year, has a right to appeal to the board for relief. Section 8(c) of the TCCAL; 72 P.S. § 5349(c). When such an appeal has been filed, the board must notify each person and each taxing district which has an interest and has the power to compel the attendance of witnesses and the

ment Law (GCAL).[10] Under both schemes, a property owner who is aggrieved by any property tax assessment has a right to appeal to a board of assessment appeals, and then to the court of common pleas which is to proceed de novo. In light of the resolution of this case, we need not and do not decide here whether the state statutory remedies are plain, adequate and complete in the context of a Section 1983 class action.[11]

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furnishing of documents. Section 8(d) of the TCCAL; 72 P.S. § 5349(d).

Section 9 of the Third Class County Assessment Law further provides that the aggrieved property owner may appeal the final decision of the board to the county court of common pleas. 72 P.S. § 5350. The court of common pleas will proceed de novo. *Appeal of U.S. Steel Corp.*, 436 Pa. 435, 260 A.2d 779 (1970).

[10]Act of May 22, 1933, P.L. 853 as amended, 72 P.S. §§ 5020-601 - 5020-602.

The General County Assessment Law applies to *Berks County*, where it is not inconsistent with the Third Class County Assessment Act. Art. 1, § 105 of the GCAL; 72 P.S. § 5020-105. *Truck Terminal Motels of America, Inc. v. Berg County Board of Assessment Appeals*, 127 Pa. Cmwlth. 408, 561 A.2d 1305 (1989), petition for allowance of appeal denied, 525 Pa. 652, 581 A.2d 576 (1990). It has a procedural remedy similar to that of the Third Class County Assessment Act. The General County Assessment Law provides that the board in each county shall bear property owners' appeals of tax assessments. Art. V, § 511 of the GCAL; 72 P.S. § 5020-511. The decision of the board can then be appealed to a court of common pleas for a de novo proceeding, with further appeals to the Superior and Supreme Courts. Art. V, 518.1, 518.2, and 519 of the GCAL; 72 P.S. §§ 5020-518.1-2, 5020-519.

[11]Taxpayers contend that the state remedies are not plain, adequate and complete because they are precluded from seeking an award of attorneys' fees via the fee shifting policy embodied in ##1983 and 1988. We need not address this issue in light of the resolution of this case.

It is noted that the federal courts in Pennsylvania have consistently ruled that both of these laws provide a taxpayer a plain, adequate, and complete remedy. *See, e.g., Garrett v. Lamford*, 582 F.2d 810 (3d Cir. 1978). The Garrett court held that the district court properly abstained from entertaining a Section 1983 class action challenging alleged discriminatory property tax assessments brought by property owners in Berks County. The court held that the class action was precluded in

The Supreme Court of the United States has consistently affirmed the duty of state courts to entertain Section 1983 actions, except where a valid excuse exists, regardless of whether plaintiffs have exhausted state administrative and judicial remedies. Municipalities may be sued under Section 1983 when a municipal policy, ordinance, regulation or custom inflicts constitutional injury. *Monell v. New York City Department of Social Services*, 436 U.S. 658, 98 S. Ct. 2018, 56 L.Ed. 2d 611 (1978). Since 1980, the Supreme Court of the United States has made clear that state courts have concurrent jurisdiction with federal courts to hear Section 1983 claims. *Maine v. Thibout*, 448 U.S. 1, 100 S. Ct. 2502, 65 L.Ed. 2d 555 (1980). When state courts entertain federal causes of action, the rights of, and the defenses to, a federal cause of action are defined by federal law so that the outcome of federal causes of action would be the same, regardless if decided in a state or federal forum. *Howlett v. Rose,* 496 U.S. 356, 375, 110 S. Ct. 2430, 2442, 110 L.Ed. 2d, 332, 353 (1990).[12] Also, in the absence of a valid excuse, state courts have no discretion to decline to accept jurisdiction when the parties and

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federal court under the Tax Injunction Act, since the Third Class County Assessment Law, affording administrative appeal with judicial review to a class, provided them with a plain, speedy and efficient remedy. *Id.* at 819.

Garrett predated significant Supreme Court rulings in section 1983 litigation and did not address the attorneys' fees issue. Therefore, it would have little probative value to this case were we to address the issue of whether the state remedies are plain, adequate and complete.

[12]The Court in Howlett reaffirmed that federal law is enforceable in state courts because the Constitution and laws passed pursuant to it are as much laws in the states as laws passed by the state legislature. 496 U.S. at 367, 110 S. Ct. at 2438, 110 L.Ed. 2d at 347. The Court held that a state law sovereign immunity defense is not available to a school board in a section 1983 action brought in a state court that otherwise has jurisdiction when such a defense would not be available if the action were brought in a federal forum. 496 U.S. at 361-83, 110 S. Ct. at 2434-47, 110 L.Ed. 2d at 343-58.

controversy are properly before the state court. 496 U.S. at 369, 110 S. Ct. at 2439, 110 L.Ed. 2d at 348.

A valid excuse may exist when a state court refuses jurisdiction because it has no competent court to hear the case or because of a neutral state rule of judicial administration, unless that rule is preempted by federal law. *Felder v. Casey*, 487 U.S. 131, 108 S. Ct. 2302, 101 L.Ed. 2d 123 (1988). The requirement that a state court of competent jurisdiction treat federal law as the law of the land does not necessarily include within it a requirement that the state create a court competent to hear the case in which the federal claim is presented. *Howlett*, 496 U.S. at 372, 110 S. Ct. at 2441, 110 L.Ed. 2d at 350-351. Neutral rules of judicial administration have included those authorizing dismissal of both federal and state claims where neither the plaintiff nor the defendant was a resident of the forum state, *Douglas v. New York, N.H. & H.R. Co.*, 279 U.S. 377, 49 S. Ct. 355, 73 L.Ed. 747 (1929), where the cause of action arose outside of the court's territorial jurisdiction, *Herb v. Pitcairn*, 324 U.S. 117, 65 S. Ct. 459, 89 L.Ed. 789 (1945), or where the doctrine of forum non conveniens appropriately applied. *Missouri ex rel. Southern R. Co. v. Mayfield*, 340 U.S. 1, 71 S. Ct. 1, 95 L.Ed. 3 (1950).

Neutral state rules of judicial administration appear to be preempted in Section 1983 cases, however, in situations where the plaintiff and defendant are residents of the forum state and the cause of action arises in the forum state. The Supreme Court of the United States has ruled that Section 1983 plaintiffs are not required to exhaust state administrative remedies before instituting Section 1983 suits in federal courts or state courts. *See Patsey v. Board of Regents of Florida*, 457 U.S. 496, 102 S. Ct. 2557, 73 L.Ed. 2d 172 (1982) and *Feller v. Carey*, supra, respectively. In Felder, nine months after being allegedly beaten by Milwaukee police officers who arrested Felder on a disorderly conduct charge that was later dropped, Felder filed a state court action against the city and certain of the officers under Section 1983. He alleged that the beating and arrest were racially motivated and violated his rights under the Fourth and Fourteenth Amendments to the United States Constitution. The officers moved to dismiss the suit because of Felder's failure to comply with Wisconsin's notice-of-

claim statute. The statute provided, in part, that: before suit may be brought in state court against a state or local governmental entity or officer, the plaintiff, within 120 days of the alleged injury, must notify the defendant of the circumstances and amount of the claim and the plaintiffs intent to hold the named defendant liable; the defendant then had 120 days to grant or disallow the requested relief; and the plaintiff must bring suit within six months of receiving notice of disallowance. 487 U.S. at 134-37, 108 S. Ct. at 2305-06, 101 L.Ed. 2d at 135-37.

The Felder Court held that when a Section 1983 action is brought in the state court, Wisconsin's notice-of-claim statute conflicted in both its purpose and effect with Section 1983's remedial objectives and was preempted pursuant to the Supremacy Clause. The court explained that while states retain the authority to prescribe the rules and procedures governing suits in their courts, that authority does not permit states to place conditions on the vindication of a federal right. Rather, congress meant to provide individuals immediate access to the federal courts and did not contemplate that those who sought to vindicate their federal rights in state courts could be required to seek redress in the first instance from the state officials whose hostility to those rights precipitated their injuries. 487 U.S. at 147-53, 108 S. Ct. at 2311-14, 101 L.Ed. 2d at 143-47.

The Felder court found no merit to the claim that the exhaustion requirement imposed by the state statute is essentially de minimis because the statutory settlement period entailed none of the additional expense or undue delay typically associated with administrative remedies, the statutory scheme did not eliminate a claimant's right to seek full compensation through suit or the statutory scheme was designed to sift out specious claims. That court emphasized that Section 1983 actions "belong in court" and exist independent of any other legal or administrative relief that may be available as a matter of federal or state law except where congress has expressly imposed an exhaustion requirement.[13] The

[13]Congress did establish an exhaustion requirement for a specific class of section 1983 actions, those brought by adult prisoners challenging the conditions of their confinement, in the Civil Rights of Institutionalized

court said that any scheme designed to sift out "specious claims" from the stream of complaints that can inundate local governments in the absence of sovereign immunity is "manifestly inconsistent" with the central objective of the civil rights statutes. 487 U.S. at 148-50, 108 S. Ct. at 2312-13, 101 L.Ed. 2d at 144-45.

We now address the critical question of whether the common pleas courts of this Commonwealth must entertain Section 1983 cases without requiring the exhaustion of state administrative and judicial remedies. We do not have direction from the United States Supreme Court on this issue; rather, we have competing lines of cases and are asked to resolve the apparent conflict.

One may argue that, according to U.S. Supreme Court precedent, the taxpayers should be no better off in state court than they are in federal court with regard to a Section 1983 case challenging the constitutionality of a property tax assessment procedure. According to Fair Assessment and its progeny, plaintiffs must exhaust state administrative and judicial remedies in a property tax assessment case before bringing a Section 1983 action in federal court. Therefore, the argument continues, the taxpayers must also exhaust state administrative and judicial remedies before bringing a Section 1983 action challenging the constitutionality of a property tax assessment procedure in state court.

One may also argue that, according to U.S. Supreme Court precedent, this court cannot require exhaustion of state statutory remedies. If an exhaustion requirement were imposed on the taxpayers, then, like Felder, the state has a procedure that places conditions on the vindication of a federal right in state court. This is so even though the state's statutory scheme does not eliminate a claimant's right to seek full compensation through suit. Further, we are mindful that the taxpayers' case has another aspect that was not present in Felder, which is that exhaustion of state administrative and judicial remedies in the taxpayers' case may entail the additional expense and delay typically associated with

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Persons Act of 1980, 94 Stat. 353, 42 U.S.C. § 1997e. In Felder, the Court stated that congress, in enacting this statute, expressly recognized that it was working a change in the law. 487 U.S. at 149, 108 S. Ct. at 2312, 101 L.Ed. at 144.

state statutory remedies without according the taxpayers the relief sought. *See Borough of Greentree v. Board of Property Assessment, Appeals and Review of Allegheny County*, 459 Pa. 268, 328 A.2d 819 (1974).[14]

Here, the record reflects that the taxpayers have exhausted state administrative procedures and, without pursuing their state judicial remedies, seek to maintain a Section 1983 class action. In this case, Felder and Howlett command the Court of Common Pleas of Berks County to exercise jurisdiction over a Section 1983 action without requiring the complete exhaustion of state statutory remedies. While exhaustion of state statutory remedies is required in federal courts, exhaustion is not required in the courts of this state insofar as the action is a class action challenging the constitutionality of a system of property tax assessment. This is so because the principle of comity that causes a federal court to refrain from exercising jurisdiction over Section 1983 tax assessment cases has no relevance to a class action challenging, in state court, the constitutionality of a system of property tax assessment.

This creates the anomalous situation that plaintiffs have quicker access to state courts with respect to these types of Section 1983 class actions than to the federal courts. This result does not appear to conflict with any U.S. Supreme Court decision because the vindication of a federal right is not shackled by state rules of judicial administration. This resolution also does not appear to conflict with precedent of this Court. *See Borough of Greentree, supra.* Further, this resolution will not, as local governments contend, disrupt state and local tax administration because, as the taxpayers argue, constitutional challenges such as the

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[14]In Greentree, this Court ruled that courts of common pleas have equitable jurisdiction to hear cases charging that the Assessment Act provision permitting triennial assessments violated the uniformity clause of the State Constitution and the equal protection clause of the Federal Constitution, where the statutory appeal procedure appearing in the Assessment Act would be of little, if any, utility in determining constitutionality of the provision and where any benefit derived from filing individual appeals with the county board of property assessment would be far outweighed by the inconvenience, delay and expense involved.

taxpayers' class-action challenge probably will, in the long run, significantly reduce the inconvenience, inefficiency, delay and expense involved in countless individual lawsuits over the same issue in many different administrative and judicial forums.[15]

On the other hand, if we were to refuse access to the courts before exhaustion of statutory remedies with respect to this type of class action, such refusal would conflict directly with U.S. Supreme Court directives. Therefore, we hold that where plaintiffs are a class of the taxpayers challenging the constitutionality of the system by which property tax assessments are made, they can maintain their Section 1983 suit in common pleas court without first exhausting their statutory remedies.[16] The Court of Common Pleas of Berks County properly determined that it had subject matter jurisdiction in this case and this matter is remanded to Commonwealth Court with direction to address the local governments' contentions contained in their appeal at 625 C.D. 1991.

Order of the Commonwealth Court reversed, and case remanded.

Mr. Justice Larsen did not participate in the decision of this case.

Mr. Justice Montemuro files a concurring opinion.

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[15]The local governments, on page 27 of their brief, state that because taxpayers do not press the issue on appeal, it is "undisputed that they can secure consideration of the constitutional objections before the board of assessment appeals and through de novo review in the court of common pleas." The local governments, however, argue the point no further, perhaps in recognition that the likelihood that the issue would be fully addressed, on the administrative side, by the very people who depend on the continued existence of the present scheme of things is quite small indeed.

[16]We wait for another day to address the issue of whether an individual plaintiff, as opposed to a class of plaintiffs, can maintain a section 1983 action in common pleas court without exhausting state statutory remedies where the challenge is to an individual assessment and not a challenge to the entire system of property tax assessment.

Mr. Justice Cappy files a dissenting opinion.

CONCURRING OPINION

MR. JUSTICE MONTEMURO

By implication, the majority acknowledges that our courts have an obligation to entertain a 1983 challenge to a state tax despite the existence of a statutory remedy. Because I believe that our courts have always had such an obligation, I join the Opinion of the Court.

DISSENTING OPINION

MR. JUSTICE CAPPY

I respectfully dissent from the majority's holding that the Appellant class of taxpayers, who seek to challenge the constitutionality of the property tax assessment system, may maintain their action under 42 U.S.C. § 1983 in common pleas court without first exhausting their state statutory remedies. Although I do not disagree with the majority's background summary of the relevant law, I differ with the majority's resolution of the "apparent conflict" in the United States Supreme Court's "competing lines of cases." (Majority opinion at 12.)

First, it must be remembered that section 1983 creates a federal cause of action. The Supreme Court in *Fair Assessment in Real Estate Association v. McNary*, 454 U.S. 100, 102 S. Ct. 177, 70 L.Ed. 2d 271 (1981), specifically held that this federal action requires exhaustion of state administrative and judicial remedies due to the sensitive nature of state tax issues. It makes no sense to undercut the Court's interpretation of federal law. Further, I believe that interests of comity[17] dictate that state courts defer to the federal framework carefully established by the United States

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[17]It is important to remember that comity works both ways. Judicial comity is "the principle in accordance with which the courts of one state or jurisdiction will give effect to the laws and judicial decisions of another, not as a matter of obligation, but out of deference and respect." BLACK'S LAW DICTIONARY 267 (6th ed. 1990).

Supreme Court, just as the federal court in *Fair Assessment* deferred to the state courts in fashioning a rule that would not disrupt a carefully fashioned state tax scheme. The majority's approach creates the anomalous result of encouraging federal claimants to flock to state courts to pursue section 1983 actions, when the precise purpose of the federal rule is to ensure that state courts may deal with the matter under state law first.

Moreover, the majority's approach virtually eliminates any opportunity for the state courts to examine the state tax scheme under the laws or Constitution of the Commonwealth. The precise concern for the sensitive nature of state tax schemes, which motivated the United States Supreme Court in *Fair Assessment*, should a fortiori motivate state courts to examine those schemes under state law first. The majority's approach obliterates this opportunity and, again, produces the incongruous result of creating a stronger, virtually exclusive federal forum for section 1983 claims in state court — rather than in federal court where the action should take priority.

The Supreme Court's decision in *Felder v. Casey*, 487 U.S. 131, 108 S. Ct. 2302, 101 L.Ed. 2d 123 (1988), in no way compels the majority's result. It must be remembered that for the state courts to require exhaustion of state remedies as a prerequisite to a section 1983 action would only be to impose upon plaintiffs in state court the same requirement that would be imposed upon them in federal court. Felder simply prohibits the application of a state rule where the rule conflicts with the remedial objectives of section 1983 and its enforcement will "frequently and predictably produce different outcomes in Section 1983 litigation based solely on whether the claim is asserted in state or federal court." 487 US. at 138. Ironically the majority's refusal to impose an exhaustion requirement creates just such a situation where different outcomes will be reached in section 1983 litigation "based solely on whether the claim is asserted in state or federal court."

I believe that, in the circumstances of this case, the Court should defer to the framework established by the federal courts. Therefore, I must respectfully dissent.